S. Hrg. 98-1008

PATENT LAW IMPROVEMENTS ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON
PATENTS, COPYRIGHTS AND TRADEMARKS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 1535

A BILL TO AMEND TITLE 35, UNITED STATES CODE, TO INCREASE THE EFFECTIVENESS OF THE PATENT LAWS AND FOR OTHER PURPOSES

AND

S. 1841

A BILL TO PROMOTE RESEARCH AND DEVELOPMENT, ENCOURAGE INNOVATION, STIMULATE TRADE, AND MAKE NECESSARY AND APPROPRIATE AMENDMENTS TO THE ANTITRUST, PATENT, AND COPYRIGHT LAWS

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PATENT LAW IMPROVEMENTS ACT

TUESDAY, APRIL 3, 1984

U.S. Senate,
Committee on the Judiciary,
Subcommittee on Patents, Copyrights and Trademarks,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room SR-325, Russell Senate Office Building, Senator Charles McC. Mathias, Jr. (chairman of the subcommittee) presiding.

Staff present: Ralph Oman, chief counsel, Charles W. Borden, professional staff member, Pamela S. Batstone, chief clerk, and Ned Griffith, staff assistant, Subcommittee on Patents, Copyrights and Trademarks; and Steve Owen, counsel to Senator Metzenbaum.

OPENING STATEMENT OF SENATOR CHARLES McC. MATHIAS, JR.

Senator Mathias. The committee will come to order. We are a small group gathered in a large room, and I hope that the sound equipment is adequate to overcome the echoes.

We will be back in this room a week from tomorrow to honor the 1983 inventor of the year. By coincidence, this award will to go a Marylander, Robert E. Fishel from the Johns Hopkins University Applied Physics Laboratory. While we annually honor an inventor of the year, I suppose we are implying an honor every year to the U.S. patent system which provides the incentive for the inventors to keep pushing forward on the frontiers of science and the applications of science.

Today the Patents, Copyrights and Trademarks Subcommittee meets to consider patent law amendments which are embodied in Senate bill 1535. We will also consider the related patent provisions in titles III, IV, and V of the President's national productivity and innovation bill, which is Senate bill 1841.

These proposals share a single goal, the strengthening of the patent system which has brought us such a harvest of innovations. The areas we will be discussing include infringements on patents by offshore production, the status of unpublished information and knowledge as prior art, patent interference reform, licensee estoppel, and the patent issues doctrine.

Many of these topics have already been examined by the Congress and by the executive branch over the past decade, but I think they deserve a fresh look today

[Copies of S. 1535, introduced by Senator Mathias, and S. 1841, introduced by Senator Thurmond, follow:]

98TH CONGRESS
1ST SESSION

S. 1535

To amend title 35, United States Code, to increase the effectiveness of the patent laws and for other purposes.

IN THE SENATE OF THE UNITED STATES

June 23 (legislative day, June 20), 1983

Mr. Mathias (for himself, Mr. Dole, and Mr. DeConcini) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend title 35, United States Code, to increase the effectiveness of the patent laws and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 271 of title 35, United States Code, is amended by adding at the end thereof the following new subsections:

"(e) Whoever without authority imports into or sells or uses within the United States a product made in another country by a process patented in the United States shall be liable as an infringer.

"(f) Whoever without authority supplies or causes to be supplied in the United States the material components of a patented invention, where such components are uncombined in whole or in part, intending that such components will be combined outside of the United States, and knowing that if such components were combined within the United States the combination would be an infringement of the patent, shall be liable as an infringer.".

SEC. 2. Section 184 of title 35, United States Code, is amended by—

(1) amending the third sentence thereof by striking out "inadvertently" and inserting after "filed abroad" the words "through error and without deceptive intent";

(2) adding at the end thereof the following new paragraph:

"In the case of an application for which a license has been obtained or an application which has been filed in the United States Patent and Trademark Office for more than six months before the filing in a foreign country, and on which no secrecy order has been issued, a license shall not be required for any modifications, amendments, supplements, divisions, or other information filed in or transmitted to the foreign country in connection with such application if such modifications, amendments, supplements, divisions, or information consist only of the illustration, exemplification, comparison, or explanation of subject matter specifically or generally disclosed in such application.".

Sec. 3. Section 185 of title 35, United States Code, is amended by adding before the period in the last sentence thereof the following: ", unless the failure to procure such license was through error and without deceptive intent, and the patent does not disclose subject matter within the scope of section 181 of this title".

Sec. 4. Section 186 of title 35, United States Code, is amended by—

(1) striking out "whoever, in violation of the provisions of section 184 of this title,"; and

(2) inserting "such" after "in respect of any".

Sec. 5. Section 103 of title 35, United States Code, is amended by adding at the end thereof the following:

"Prior art shall not include unpublished information which is developed by the applicant singly or jointly with others, or which is known to the applicant only by virtue of his or her employment.".

Sec. 6. Section 116 of title 35, United States Code, is amended by amending the first paragraph to read as follows:

"When two or more persons have made inventive contributions to the subject matter claimed in an application, they shall apply for patent jointly and each shall sign the application and make the required oath, except as otherwise provided in this title. Joint inventors need not have made an inventive contribution to each claim of the application.".

SEC. 7. Section 135(a) of title 35, United States Code, is amended by adding at the end thereof the following: "Evidence to establish priority of invention in accordance with section 102(g) shall be provided by affidavit.".

SEC. 8. Section 135(c) of title 35, United States Code, is amended by—

(1) inserting before "shall render" in the third sentence the following: ", unless such failure was through error and without deceptive intent,"; and

(2) striking out the words "during the six-month period" in the fourth sentence and "within the six-month period" in the sixth sentence.

SEC. 9. Section 135 of title 35, United States Code, is amended by adding at the end thereof the following new subsection:

"(d) Parties to a patent interference may determine such contest or any aspect thereof by arbitration. The parties shall give notice of any arbitration award to the Commissioner, and such award shall be dispositive of the issues to which it relates. The arbitration award shall be unenforceable until such notice is given.".

SEC. 10. (a) Title 35, United States Code, is amended by adding after section 294 the following new section:

"§ 295. Licensee estoppel

"(a) A licensee shall not be estopped from asserting in judicial action the invalidity of any patent to which it is licensed. Any agreement between the parties to a patent license agreement which purports to bar the licensee from asserting the invalidity of any licensed patent shall be unenforceable as to that provision.

"(b) In the event of an assertion of invalidity by the licensee in a judicial action, licensee and licensor shall each have the right to terminate the license at any time after such assertion. Until so terminated by either party, the licensee shall pay and the licensor shall receive the consideration set in the license agreement.".

(b) The table of sections for chapter 29 of title 35, United States Code, is amended by adding after the item relating to section 294 the following:

"295. Licensee estoppel.".

SEC. 11. The amendments made by this Act shall apply to all unexpired United States patents granted before or after the date of enactment of this Act.

98TH CONGRESS
1ST SESSION

S. 1841

To promote research and development, encourage innovation, stimulate trade, and make necessary and appropriate amendments to the antitrust, patent, and copyright laws.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 14 (legislative day, SEPTEMBER 12), 1983

Mr. THURMOND (by request) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To promote research and development, encourage innovation, stimulate trade, and make necessary and appropriate amendments to the antitrust, patent, and copyright laws.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—SHORT TITLE

SEC. 101. This Act may be cited as the "National Productivity and Innovation Act of 1983".

TITLE II—JOINT RESEARCH AND DEVELOPMENT VENTURES

SEC. 201. For purposes of this title—

(1) the term "joint research and development program" means—

(A) theoretical analysis, exploration, or experimentation; or

(B) the extension of investigative findings and theories of a scientific or technical nature into practical application, including the experimental production and testing of models, devices, equipment, materials, and processes;

to be carried out by two or more independent persons: *Provided,* That for purposes of this title, such a program may include the establishment of facilities for the conduct of research, the collecting and exchange of research information, the conduct of research on a protected and proprietary basis, the prosecution of applications for patents, the granting of licenses, and any other conduct reasonably necessary and appropriate to such program;

(2) the term "antitrust laws" has the meaning given it in section 1 of the Clayton Act (15 U.S.C. 12), except that the term shall also include section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent that said section 5 applies to unfair methods of competition;

(3) the term "Attorney General" means the Attorney General of the United States; and

(4) the term "Commission" means the Federal Trade Commission.

SEC. 202. No joint research and development program shall be deemed illegal per se in any action under the antitrust laws.

SEC. 203. (a) Notwithstanding the provisions of section 4 of the Clayton Act (15 U.S.C. 15), any person entitled to recovery in an action under said section 4 based on conduct that is part of a research and development program and that is engaged in after a notification disclosing such conduct has been filed with the Attorney General and the Commission pursuant to section 204 shall recover the actual damages by him sustained, interest calculated in accordance with the provisions of section 1961 of title 28, United States Code, on such actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit, including a reasonable attorney's fee.

(b) Notwithstanding the provisions of section 4C of the Clayton Act (15 U.S.C. 15c), any State entitled to monetary relief in an action under said section 4C based on conduct that is part of a research and development program and that is engaged in after a notification disclosing such conduct has been filed with the Attorney General and the Commission pursuant to section 204 shall be awarded as monetary relief the total damage sustained as described in paragraph (1) of subsection (a) of said section 4C, interest calculated in accordance with the provisions of section 1961 of title 28, United States Code, on such total damage for the period beginning on the date of service of such State's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit, including a reasonable attorney's fee.

SEC. 204. (a) Any person participating in a joint research and development program may file with the Attorney General and the Commission a notification disclosing such program. Such notification shall specify the identity of the parties participating in the program, the nature, scope, and duration of the program, and any and all ancillary agreements or understandings. Only conduct specified in a notification filed pursuant to this section shall be entitled to the protections of section 203.

(b)(1) Except as provided in subsection (d), within thirty days of the filing of any notification pursuant to this section, the Commission shall cause to be published in the Federal Register notice of such notification, describing in general terms the participants, the program, and its objectives.

(2) Except as provided in subsections (c) and (d), all information and documentary material submitted as part of a notification filed pursuant to this section shall be available to the public upon request within thirty days after their submission to the Attorney General and the Commission.

(c) Any person filing a notification pursuant to this section may request that information or documentary material submitted as part of such notification not be made public. Any such request shall specify precisely what information or documentary material should not be made public, state the minimum period of time during which nondisclosure to the public is considered necessary, and justify the request for nondisclosure to the public both as to content and time. The Attorney General and the Commission shall consult with one another with respect to any such request, and each in its sole discretion shall make a final determination as to whether good cause for nondisclosure to the public has been shown. Any information or documentary material that is withheld from disclosure to the public pursuant to this subsection shall be exempt from disclosure under section 552 of title 5, United States Code.

(d) Any person who has filed a notification pursuant to this section may withdraw such notification prior to the time at which notice of such notification is published in the Federal Register and information and documentary material submitted as part of such notification is made publicly available pursuant to subsection (b). Any notification so withdrawn shall have no force or effect, notice of such notification shall not be published in the Federal Register, and no information or documentary material submitted as part of such notification shall be made publicly available.

(e) Actions taken or not taken by the Attorney General or Commission in response to or with respect to notifications filed pursuant to this section, including without limitation determinations regarding the content of notices published or to be published in the Federal Register pursuant to subsection (b), the withholding from public disclosure of information or documentary material pursuant to subsection (c), and whether to institute antitrust or other investigations or enforcement actions shall not be subject to judicial review.

TITLE III—INTELLECTUAL PROPERTY LICENSING UNDER THE ANTITRUST LAWS

SEC. 301. The Clayton Act, as amended (15 U.S.C. 12 et seq.), is amended by renumbering section 27 as section 28 and by adding the following new section 27:

"SEC. 27. (a) Agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws.

"(b)(i) Notwithstanding the provisions of section 4 of this Act, any person entitled to recovery in an action under said section 4 based on an agreement described in subsection (a) of this section shall recover the actual damages by him sustained, interest calculated in accordance with the provisions of section 1961 of title 28, United States Code, on such actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit, including a reasonable attorney's fee.

"(ii) Notwithstanding the provisions of section 4C of this Act, any State entitled to monetary relief in an action under said section 4C based on an agreement described in subsection (a) of this section shall be awarded as monetary relief the total damage sustained as described in paragraph (1) of subsection (a) of said section 4C, interest calculated in accordance with the provisions of section 1961 of title 28, United States Code, on such total damage for the period beginning on the date of service of such State's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit, including a reasonable attorney's fee.".

TITLE IV—PATENT AND COPYRIGHT MISUSE

SEC. 401. Section 271 of title 35, United States Code, is amended—

(a) by redesignating subsection (c) as paragraph (c)(1);

(b) by redesignating subsection (d) as paragraph (c)(2); and

(c) by adding the following new subsection (d):

"(d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following, unless such conduct, in view of the circumstances in which it is employed, violates the antitrust laws: (1) licensed the patent under terms that affect commerce outside the scope of the patent's claims, (2) restricted a licensee of the patent in the sale of the patented product or in the sale of a product made by the patented process, (3) obligated a licensee of the patent to pay royalties that differ from those paid by another licensee or that are allegedly excessive, (4) obligated a licensee of the patent to pay royalties in amounts not related to the licensee's sales of the patented product or a product made by the patented process, (5) refused to license the patent to any person, or (6) otherwise used the patent allegedly to suppress competition.".

SEC. 402. Subsection (a) of section 501 of title 17, United States Code, is amended by adding at the end thereof the following: "No copyright owner otherwise entitled to relief for infringement of a copyright under this title shall be denied relief or deemed guilty of misuse or illegal extension of the copyright by reason of his having done one or more of the following, unless such conduct, in view of the circumstances in which it is employed, violates the antitrust laws: (1) licensed the copyright under terms that affect commerce outside the scope of the copyright, (2) restricted a licensee of the copyright in the sale of the copyrighted work, (3) obligated a licensee of the copyright to pay royalties that differ from those paid by another licensee or that are allegedly excessive, (4) obligated a licensee of the copyright to pay royalties in amounts not related to the licensee's sales or use of the copyrighted work, (5) refused to license the copyright to any person, or (6) otherwise used the copyright allegedly to suppress competition.".

TITLE V—PROCESS PATENTS

SEC. 501. Section 154 of title 35, United States Code, is amended by inserting after "invention" the second time it appears the words ", and if the invention is a process of the right to exclude others from using or selling products produced thereby,".

SEC. 502. Section 271 of title 35, United States Code, is amended—

(a) by redesignating subsection (a) as paragraph (a)(1); and

(b) by inserting the following new paragraph (a)(2):

"(a)(2) If the patented invention is a process, whoever without authority uses or sells in the United States during the term of the patent therefor a product produced by such process infringes the patent.".

SEC. 503. Title 35, United States Code, is amended by adding the following new section 295:

"§ 295. Presumption: Product Produced by Patented Process.

"In actions alleging infringement of a process patent based on use or sale of a product produced by the patented process, if the court finds (1) that a substantial likelihood exists that the product was produced by the patented process and (2) that the claimant has exhausted all reasonably available means through discovery or otherwise to determine the process actually used in the production of the product and was unable so to determine, the product shall be presumed to have been so produced, and the burden of establishing that the product was not produced by the process shall be on the party asserting that it was not so produced.".

Senator MATHIAS. In order to make sure that we get through the whole witness list, I am going to ask each witness to confine oral delivery to 5 minutes, summarizing, if they wish, their written statements. But the written statements, I can assure you, will be included in full in the record.

The record will remain open for 3 weeks so that witnesses who wish to make additional statements or supply additional information may have an opportunity to do so.

Our first witness will be the Honorable Gerald J. Mossinghoff, Assistant Secretary and Commission of Patents and Copyrights.

Mr. Secretary.

STATEMENT OF HON. GERALD J. MOSSINGHOFF, ASSISTANT SECRETARY AND COMMISSIONER OF PATENTS AND TRADEMARKS, PATENT AND TRADEMARK OFFICE, WASHINGTON, DC, ACCOMPANIED BY RENE D. TEGTMEYER, ASSISTANT COMMISSIONER FOR PATENTS

Secretary MOSSINGHOFF. Thank you, Mr. Chairman. Good morning. We welcome this opportunity to testify on the bill you introduced, S. 1535, a bill which would correct a number of troublesome aspects of the patent laws and thereby enhance the benefits of the patent system to inventors and businesses.

Accompanying me today, Mr. Chairman, is Mr. Rene Tegtmeyer, the Assistant Commissioner for Patents, and an expert on some of the areas that we are going to testify on.

With your permission, Mr. Chairman, and to stay within the time limit, I would propose to read just parts of my statement which, in turn, highlight the position of the administration on the bill.

Senator MATHIAS. Since you are a double team, you are entitled to a little extra time. So you may proceed as you see fit.

Secretary MOSSINGHOFF. Thank you, Mr. Chairman.

Mr. Chairman, section 1 of the bill would protect owners of patented processes from infringement of their inventions by excluding others from using or selling products produced by the patented process, as you note.

Presently, the infringement of a patent for a product occurs if the patented invention is made, used, or sold in the United States. Someone cannot avoid infringement of a product patent by manufacturing the product overseas and then importing it into this country, because use or sale of the product in the United States would infringe the patent.

A process patent, however, only protects a process or method of making an article or product. Today, the holder of a U.S. process patent cannot use the patent law to prevent someone from practicing the patented invention abroad and selling or using the resulting product in the United States.

Technically, no one has used the patented process in this country nor do the remedies available under section 337a of the Tariff Act of 1930, as amended, always provide an adequate remedy.

The importance of process patent protection to the national economy, especially in such vital technical fields as industrial chemicals and pharmaceuticals manufacturing, microbiology, and solid state electronics, cannot be overestimated.

The addition of section 271(e), as proposed in section 1 of S. 1535, would close the gap in our patent laws which presently leaves owners of patented processes without an adequate remedy against the importation of products made abroad by their patented processes.

However, S. 1535 is limited to foreign-produced products. There is no remedy under this bill against the use or sale of a product made in the United States by infringing a product patent.

Foreign products are, therefore, treated less favorably than domestic products. The Office of the U.S. Trade Representative has expressed concern that it would violate our obligations under article III of the General Agreement on Tariffs and Trade, the GATT agreement, not to discriminate against foreign-made products.

S. 1841, which you mentioned in your opening statement, introduced by Chairman Thurmond at the request of the administration, does not suffer from this deficiency. Title V of S. 1841 would make the use of sale of a product made without authorization by a process patented in the United States an infringement irrespective of where the product was made.

I supported S. 1841 in my testimony this past October with Secretary Baldrige before the Committee on the Judiciary.

Mr. Chairman, in the interest of time, I would skip to page 4 of my prepared statement and address the other aspect of section 1 of S. 1535. That section also addresses a problem identified by a 1972 decision of the Supreme Court in *Deepsouth Packing Company* v. *Laitram.*

The Supreme Court, in a narrow decision interpreting the patent owner's rights to exclude others from making a patented invention, held that this right only covers the making of the patented invention in the United States.

The patent claimed a machine for deveining shrimp. All of the machine's parts were manufactured by the accused infringer in the United States. To avoid infringement, however, the machine was not assembled in the United States. Rather, parts were shipped abroad, together with simple instructions for assembly. Assembly was a simple matter, taking less than an hour.

The Supreme Court decided, based on their reading of the patent laws as then written—this was not a broad policy decision by any means; it was a narrow construction of the patent laws—that section 271 of title 35 did not apply.

Moreover, the accused infringer was not even guilty of contributory infringement or inducement to infringe because the requirement that there must first be a direct infringement in the United States was not satisfied.

The Supreme Court acknowledged the narrowness of the law and stated that legislation is needed if the patentee is to have a remedy in these situations. Legislative remedies have been included in past comprehensive patent reform bills, but none has been enacted. A legislative remedy against such activities, we believe, is necessary to provide the patentee with effective protection.

Mr. Chairman, sections 2, 3, and 4 of S. 1535 address various provisions in chapter 17 dealing with national security and the filing of applications abroad. These sections would clarify certain provisions of the patent laws relating to the filing of patent applications in foreign countries, and we support them.

Mr. Chairman, skipping now to section 5 of the bill which I discuss on page 11 of my statement, that would clarify an inventor's right to receive a patent by specifying in title 35, section 103, that prior art shall not include unpublished information which is developed by the applicant singly or jointly with others or which is known to the applicant only by virtue of his or her employment.

This would avoid a problem which was identified in a line of cases beginning with the case of *In re Bass,* a 1973 Court of Customs and Patent Appeals decision. We believe that a change in the patent laws is needed to assure that unpublished technical information not be regarded as prior art in judging nonobviousness.

Drafting an appropriate provision, however, has proved to be an elusive and complex task. We believe that section 5 is too broad as it is written in S. 1535. We are aware that on March 15, the American Intellectual Property Law Association forwarded to Chairman Kastenmeier on the House side a letter which urged an amendment of section 103 more specifically aimed at the problem. I have taken the liberty of including a copy of that letter with my testimony, and we would prefer the wording proposed by the American Intellectual Property Law Association to that included in S. 1535.

The wording proposed by the American Intellectual Property Law Association may also be useful in solving the issue of naming inventors. That is addressed in section 6 of the bill, and again, we support the principle behind it but we prefer the wording of the American Intellectual Property Law Association.

With respect to sections 7, 8, and 9 of the bill, the U.S. patent law, unlike those of most other countries, awards patent rights to the first inventor. The procedure by which we determine which of rival inventors is the first inventor is decided in an interference proceedings which is a very complex proceeding in the Patent and Trademark Office.

Section 7 is an attempt to simplify and speed up interferences, and we strongly support that. It would require that parties rely on affidavit evidence in proving inventorship or disproving a rival's claim on inventorship. Presently, parties usually rely on testimony of witnesses taken by deposition on oral examination.

We oppose the enactment of section 7 of S. 1535 for several reasons. It would take away any flexibility the Office would have to obtain testimony by means other than affidavits and means better suited to the circumstances.

Many interferences are presently disposed of through use of stipulated testimony. The testimony of hostile witnesses cannot effectively be obtained by affidavit, and in many cases it may be desirable to test the credibility of witnesses through cross-examination. We believe that this is a matter best left to rulemaking by the Patent and Trademark Office.

Section 8 of the bill would amend 35 U.S.C. 135(c) to provide that the penalties for failing to file an agreement after a settlement of an interference would not apply if the failure was a consequence of an error committed without deceptive intent.

Section 8 would not have any effect on the kinds of agreements that must be filed. The Department of Justice opposes enactment of section 8 on the ground that its potential benefits would be outweighed by the possibility that interference parties may enter into collusive interference settlement agreements. On this issue, Mr. Chairman, the Department of Commerce defers to the Department of Justice, since they are the people who review these filings.

Section 9 of the bill would permit parties to an interference to resolve it through arbitration, and we strongly support the principle of that section.

Finally, Mr. Chairman, section 10 of the bill would codify the decision reached by the Supreme Court in *Lear* v. *Adkins,* a 1969 opinion in which the Supreme Court overturned the judicial doctrine of licensee estoppel. Prior to the *Lear* decision, a licensee was precluded from questioning the validity of any patent under which it was licensed.

The *Lear* case assures a licensee the right to challenge the validity of any such patent. The Supreme Court recognized the public interest in freedom from invalid patents and further that the licensee is the party most able and most likely to challenge validity.

As a result of *Lear,* however, the licensee is, at times, able to attack patent validity under conditions competitively unfair to the licensor. A licensee, for example, can negotiate the best license terms available, and then turn around, accept a contract, and question patent validity without relinquishing the license. If he wins the patent validity suit, he can, of course, practice the invention safe in the knowledge that the patent is invalid. If he loses, the licensee merely continues to pay the agreed upon royalties. In effect, he can have his cake and eat it, too, risking nothing but attorneys' fees in a challenge.

In fact, some courts have even held that it may be possible for the licensee to pay royalties to an escrow account during the pendency of the suit over validity rather than directly to the licensor.

A fairer balance between the rights of the licensor and those of the licensee is needed without compromising the public interest. New section 295(b) proposed by section 10 would achieve this balance with a number of straightforward principles. Either the licensor or the licensee could terminate the license once the licensee asserts invalidity in a judicial action. However, the licensee would have to continue to pay royalties directly to the licensor unless the license is terminated. Upon termination by either party, further unlicensed practice of the patented invention would subject the former licensee to the infringement provisions of the patent laws.

We support these principles for their basic fairness to both of the parties. However, we believe the statute should not be drafted in the form of section 10, which would increase Federal interference in patent licensing. We believe the correct approach is to do exactly the opposite. Parties should be properly able to negotiate contracts containing provisions, for instance, that a licensor or licensee could terminate if the licensee challenged the validity of the license in a judicial proceeding.

This section should, therefore, assure the parties that any such licensing provisions which they negotiate will not be deemed unenforceable as inconsistent with Federal objectives.

Mr. Chairman, that position is supported both by the Department of Justice and by the Department of Commerce, in other words, to free license agreements, let the parties negotiate what they will in terms of termination, and make sure that the section is drafted so that that is not regarded as an infringement of any Federal rights that might obtain.

Mr. Chairman, that completes the summary of my prepared statement, which is rather lengthy. We would be pleased, Mr. Tegtmeyer and I, to answer any questions you may have.

Senator MATHIAS. One question which may not be an entirely fair one, because in your statement you set out the merits of the various proposals, but meritorious as they are, they are not likely to be unanimous.

Suppose you had to choose among them. What do you think is the most urgently necessary of the reforms that have been suggested.

Secretary MOSSINGHOFF. I guess, in order, I would say that, at least from my reading, there is virtually unanimous support for the provision that would make the use or sale of a product made by a patented process an infringement, and that is something that most of our developed country partners in the patent world have. I think it is without controversy in the United States.

So I would put that at the top of the list. That has been included in the bill that President Reagan sent forward sometime earlier this year.

I think the provisions on foreign licensing are also very important. We have already cleared with the Office of Management and Budget regulations which would address some of the problems that would be involved. There is total consensus within the Government, both in the Commerce Department and in all the defense agencies, that this is a good thing to do, and we think that these provisions are, therefore, fairly noncontroversial.

Then, I guess the two other major provisions would be *Lear*—providing a remedy for what we see as an inequity resulting from the Supreme Court case in *Lear* v. *Adkins*. And finally, we recommend changing the law so that the *Deepsouth* Supreme Court case would be decided differently in the future.

So, in that order, I would say first process patent protection; second, foreign filing; third, *Lear* v. *Adkins*; and fourth, the *Deepsouth* issue.

Senator MATHIAS. You suggested that those provisions of S. 1535, specifically section 271(f), should be confined to components made especially for use in the infringement of a patent and should not apply to staple items; is that correct?

Secretary MOSSINGHOFF. That is correct.

Senator MATHIAS. Suppose the exporter sends specific instructions on how to manufacture a product which infringes on a U.S. patent, notwithstanding the use of staple products.

Secretary MOSSINGHOFF. That would be a closer call. The recommendation that we are making with respect to staple items is already in the patent laws in section 271(c) with respect to contributory infringement.

As long as you are selling a staple article in commerce, you cannot be charged with being guilty of contributory infringement.

On the other hand, section 271(b) is a provision that says that you can be liable as an infringer if you actively induce infringement.

That subsection may be in line with what is inherent in your question. It may be that that concept also might be woven in, where you actively induce infringement abroad. Perhaps you could take the wording of both 271(b) and 271(c) in the new section. That might be a good idea. I really have not thought that through but it sounds like a good suggestion, using the present principles that are in section 271 and apply them abroad.

Senator MATHIAS. One final question. In the proposal that deals with the Lear situation, it contemplates, in effect, a voluntary termination of the license, if the licensee alleges the invalidity of the patent.

At what point, do you see this as being an option? Does the licensee have to surrender his license as soon as he wins his action, or would it only come into play when a judicial action is brought, that would be the trigger.

But could he hold on to the license after that or must he give it up as soon as he brings a judicial action?

Secretary MOSSINGHOFF. Well, under our recommendation, again, worked out with the Department of Justice and generally supported by both Commerce and Justice, under our recommendation, parties to a license agreement would be free to negotiate that based on the individual circumstances of their arrangements. So when the licensor and the licensee enter into the agreement, they could decide themselves when they would trigger a termination of the provision, and it would leave a lot more flexibility than would presently be provided through section 10.

Senator MATHIAS. This was my question. You contemplate this as part of the original agreement?

Secretary MOSSINGHOFF. That is our recommendation—that the Federal law be made clear. It would require a statutory change, that when parties enter into a license agreement, they could decide at that time what the consequences of the licensee's challenging the licensor's patents would be.

Many agreements involve more than one patent, and it is a matter of looking at the individual circumstances.

Senator MATHIAS. Will this result in boilerplate language being included in every original agreement?

Secretary MOSSINGHOFF. I think the licensor would come to the table with boilerplate language that will be subject to negotiations. It gets particularly complicated if there is a cross-licensing agreement or if there are multiple patents involved. Each party would have to decide what would be the consequence of challenging one or the other of these patents.

Senator MATHIAS. We thank you for starting us off this morning. We appreciate your being here.

Secretary MOSSINGHOFF. Thank you, Mr. Chairman.

[The following statement, with attachment, was received for the record:]

PREPARED STATEMENT OF GERALD J. MOSSINGHOFF

Mr. Chairman and Members of the Subcommittee:

I welcome this opportunity to testify on S.1535, a bill which would correct a number of troublesome aspects of the patent laws and thereby enhance the benefits of the patent system to inventors and businesses.

Section 1

Section 1 would protect owners of patented processes from infringement of their inventions by excluding others from using or selling products produced by the patented process. Presently, the infringement of a patent for a product occurs if the patented invention is made, used or sold in the United States. Someone cannot avoid infringement of a product patent by manufacturing the product overseas and then importing it into this country, because use or sale of the product in the United States would infringe the patent.

A process patent, however, only protects a process or method of making an article or product. Today, the holder of a United States process patent cannot use the patent law to prevent someone from practicing the patented process abroad and selling or using the resulting product in the United States. Technically, no one has used the patented process in this country. Nor do the remedies available under section 337a of the Tariff Act of 1930, as amended, always provide an adequate remedy.

The importance of process patent protection to the national economy, especially in such vital technical fields as industrial chemical and pharmaceutical manufacturing, microbiology and solid state electronics, cannot be overestimated.

The addition of section 271(e), as proposed in Section 1 in S.1535, would close the gap in our patent laws, which presently leaves owners of patented processes without an adequate remedy against the importation of products made abroad by their patented processes. However, S.1535 is limited to foreign produced products. There is no remedy under this bill against use or sale of a product made in the United States by infringing a process patent. Foreign products are, therefore, treated less favorably than domestic products. The Office of the United States Trade Representative has expressed concern that it would violate our obligation under Article III of the GATT not to discriminate against foreign made products.

S.1841, introduced by Chairman Thurmond at the request of the Administration, does not suffer this deficiency. Title V of

S.1841 would make the use or sale of a product made without authorization by a process patented in the United States an infringement irrespective of where the product was made. I supported S.1841 in my testimony this past October before the Committee on the Judiciary.

Moreover, the provisions of S.1535 are somewhat ambiguous as to when the making of a product or the importation, use or sale of such a product would have to occur in order for a process patent to be infringed. For example, it is unclear under S.1535 whether a process patent is infringed if a product is made during the patent term, but imported, sold or used after the patent expires. On the other hand, Title V of S.1841 would apply to products used or sold during the term of the process patent, regardless of when the product was made. For all these reasons, we prefer the formulation of S.1841 over that of S.1535.

Title V of S.1841 also includes a provision on proving infringement, not found in S.1535, that is very important to patent owners. In suing for infringement of a process patent, the burden of establishing infringement now rests entirely on the patent owner. New section 295, proposed in Title V, would in certain carefully prescribed circumstances establish a presumption that a product that could have been made by a patented process was actually made by that process. This new section may be of particular benefit to the owner of a process patent who seeks a remedy against the importer of a product made abroad by that process, since the laws of most countries do not provide the discovery procedures available through United States courts. This frequently makes it very difficult to secure proof of actions taken in a foreign country.

Shifting the burden of proof, as would S.1841, should create no substantial hardship, since the alleged infringer is in a much better position to establish that the product was made by another method. An accused infringer, if not actually the manufacturer, has direct or at least indirect contact with the manufacturer.

An infringer will be protected against frivolous suits by a requirement that the patentee first show a substantial likelihood that an allegedly infringing product, which could have been made by the patented process, was in fact so produced. Such factors as the absence of other economically viable processes or the presence of tell-tale side effects or trace elements could satisfy the requirement. The patentee would also be required to make a reasonable effort to determine how the product was actually made, and also show that he or she was unable to make that determination.

Because, in our view, Title V of S.1841 offers stronger protection to patent owners, we prefer its provisions over those of S.1535 to add a new section 271(e) to title 35.

Section 1 of S.1535 also addresses the problem identified by the 1972 decision of the Supreme Court in Deepsouth Packing Co. v. Laitram Corp., 406 U.S. 518, 173 U.S.P.Q. 769 (1972), by adding new section 271(f). The Supreme Court, in a narrow decision interpreting the patent owner's right to exclude others from making a patented invention, held that this right only covers the making of the patented invention in the United States. The patent claimed a machine for deveining shrimp. All of the machine's parts were manufactured by the accused infringer in the United States. To avoid infringement, however, the machine was not assembled in the United States. Rather, the parts were shipped separately to foreign purchasers with instructions for assembly. Assembly was a simple matter, taking about an hour.

The Supreme Court decided that since the machine was not built in the United States, section 271 (the patent infringement provision) did not apply. Moreover, the accused infringer was not even guilty of contributory infringement or inducement to infringe, because the requirement that there must first be direct infringement in the United States was not satisfied.

The Supreme Court acknowledged the narrowness of the law and stated that legislation is needed if the patentee is to have a remedy in these situations. Legislative remedies have been included in past comprehensive patent reform bills, but none has been enacted. A legislative remedy against such activities is necessary to provide the patentee with effective protection.

We have two suggestions for sharpening the remedy provided in S.1535. As presently drafted, it might deter the sale of components which are staple articles suitable for substantial noninfringing use. We believe it should be limited to the sale of components which are especially made or adapted for use in an infringement of a patent. This approach was taken by Congress in section 271(c) of the patent laws dealing with contributory infringement. In order to avoid interference with the export sale of staple articles of commerce, the limitations of section 271(c) should be incorporated into proposed section 271(f).

Secondly, we suggest deletion of the phrase in proposed section 271(f) requiring the infringer to have knowledge that combining the invention's components in the United States would be an infringement. Under the patent laws today, a patent may be infringed without the infringer's knowing that he is doing so. It is inconsistent and unfair, therefore, to provide a remedy for overseas assembly of a patented device only if the exporter knows that such assembly will infringe the patent. It is enough that the infringer intends for the components of the invention to be combined outside of the United States. The patent owner, in cases of assembly abroad, deserves the same rights as those available to other patent owners.

We would suggest that Section 11 of S.1535 be amended so that Section 1 only apply to acts committed after the bill was introduced, regardless of when the patent issued. Acts not regarded as infringements prior to introduction of the bill should not, upon its enactment, become infringements. This would be unfair to persons who in good faith prior to the introduction of S.1535 imported, used or sold an article made abroad by a patented process or sold in the United States components of a patented article for foreign assembly. Also, extensive preparations before introduction for such practices should not be unfairly penalized.

Sections 2, 3 and 4

Sections 2, 3 and 4 of S.1535 address various provisions in chapter 17 of the patent laws dealing with national security.

These Sections would clarify certain provisions of the patent laws relating to the filing of patent applications in foreign countries. According to present 35 USC 184, a patent application for an invention made in the United States cannot be filed in a foreign country unless the applicant first obtains a foreign filing license from the Office, or unless the corresponding or equivalent application has been pending in the Patent and Trademark Office for at least six months and no secrecy order has been imposed. Section 184 also proscribes the filing without a supplemental license of any modification, amendment, supplement or division to, or of, a foreign application, that is, any paper disclosing additional subject matter. For the sake of simplicity, I will refer to them collectively as a modification.

In situations where an application or modification was filed abroad without a license, the patent applicant may have an opportunity to obtain a retroactive license. A retroactive license is available where the applicant can establish that the filing abroad was inadvertent and that the application or modification does not contain subject matter within the secrecy order scope of section 181, the disclosure of which might be detrimental to national security. Failing to obtain a license either prior to filing abroad or retroactively, however, invalidates the corresponding United States patent (section 185) and may subject the applicant to criminal penalties (section 186).

The first part of Section 2 would amend section 184 in the following manner: It would replace the standard of "inadvertence" for receiving a retroactive license with the phrase "through error and without deceptive intent." This new standard, which we support, properly takes into account the fact that failing to obtain a needed license can be a willful act, even though done with the best intentions and without any realization of a failure to comply with the license requirement. "Inadvertence," on the other hand, carries a connotation that the applicant did something he did not intend to do. Harmless judgmental errors made in good faith would, therefore, under the new standard no longer preclude the grant of a retroactive license. Even with the amendment, a retroactive license could not be granted under the Section if the subject matter filed abroad comes within the secrecy order scope of 35 USC 181.

To implement this provision, we could establish by rule a modified "diligence" requirement for obtaining a retroactive license. Currently, there is no mention either in the present law, or in S.1535, of any time limit or period by which an applicant or patent owner must apply for a retroactive license, once the need for such a license is discovered. Moreover, no court has imposed a "diligence" requirement. In exercising his discretionary authority, however, the Commissioner has demanded diligence by applicants and patent owners in applying for retroactive licenses, and the courts have agreed with the Commissioner's right to require such diligence.

Our contemplated regulations would not require a patent owner to review or inspect every patent file to determine if a retroactive license was needed but not obtained. Applicants would, of course, be expected to be diligent during the pendency of an application in seeking a retroactive license if they learn of a problem, since it is in the national interest to learn of disclosures of security sensitive information at the earliest possible date. In addition, the public has an interest in knowing at the earliest possible date that a patent is invalid under Section 185.

The second part of Section 2 would add a paragraph to 35 USC 184, exempting an applicant from the obligation to obtain a supplemental license for any modification to be filed abroad, if the modification consists only of the illustration, exemplification, comparison or explanation of subject matter previously specifically or generally disclosed either in a licensed foreign application or in an application that did not require a license for foreign filing. Under this provision, the applicant would be given authority to apply the statutory test to determine whether the subject matter of the modification requires a license.

The proposed amendment of section 184 is intended to moderate the stricter test imposed by the former United States Court of Customs and Patent Appeals in In re Gaertner, 604 F.2d 1348, 202 U.S.P.Q. 714 (C.C.P.A. 1979), for receiving a retroactive license. In that case, the Court indicated that the subject matter of a modification is exempted from the license requirement only when it is recited *in* haec verbis in the application or is so commonly known that it can be said to be in fact expressly disclosed.

While we agree with the general concept of the second part of Section 2 of the bill, corrective legislation seems unnecessary since the Commissioner already has the authority to adopt appropriate rules under the present statute. The obtaining of foreign filing licenses is better handled by appropriate modification of our Rules of Practice under the present statute. This provides a flexibility and degree of detail not available from a statutory provision, while still guarding national security and the rights of applicants. We have developed appropriate rules along these lines and will publish them later this week.

Approximately 93% of the patent applications filed do not contain subject matter which might be detrimental to national security. These applications need not be referred to the defense agencies for review. The rules adopted in 1983 already provide that the filing of an application is considered a petition for a license, and applications not needing referral to a defense agency now receive a license as part of the filing receipt.

The new rules will further simplify the matter by providing a broader scope license for foreign filing permitting also the filing of a subsequent modification containing added subject matter in these cases without obtaining a supplemental license, provided that such modification does not change the general nature of the subject matter described in the originally filed foreign application and does not involve certain sensitive technologies. The term "general nature of the subject matter described" is further defined in our rules by specific examples.

The remaining 7% of applications must each be reviewed by a defense agency, and the subject matter of each may or may not be eligible for a foreign filing license. If a foreign filing license is granted, a supplemental license will be needed for filing any modification.

S.1535 would not protect national security interests in this 7% segment of cases as completely as would our regulations. Once a foreign filing license is granted for an application, S.1535 does not require review by a defense agency to determine if a supplemental license is needed for the filing of a modification. Making even minor additions to the subject matter licensed for foreign filing might, in borderline cases, introduce national security considerations which would not come to the attention of a defense agency.

Although additional statutory authority is not necessary for the Office to promulgate its new regulations, we have no objection to the addition of a requirement in section 184 that the Commissioner institute rules along the lines of the new regulations, provided it leaves sufficient latitude to fix conditions assuring protection of national security interests. Addition of the following paragraph to section 184 as a substitute for that of the second part of Section 2 of S.1535 would be acceptable:

> "Subject to such conditions as the Commissioner may set by regulations, the scope of a license shall permit subsequent modifications, amendments, and supplements containing additional subject matter when the application upon which a license request is based is not required to be made available for inspection under section 181 of this title."

Section 3 of S.1535 complements the first part of Section 2 by amending section 185 of the patent laws. It is intended to shield a patent from invalidation for failure to obtain a license, if that failure was the result of error without deceptive intent and the subject matter was not within the scope of section 181. We do not believe it is necessary, however, to amend section 185 in order to achieve this result. The amendment to section 184 would apply both to patents and applications for which a retroactive license is sought, and the amendment to section 185 is redundant.

Section 186 of the patent laws sets criminal penalties for failing, innocently or not, to obtain a license under section 184, and not correcting that failure, if possible, by obtaining a retroactive license. Section 4 would amend section 186 to decriminalize section 184 violations. The Section, therefore, makes a distinction between violations of section 184 and violations of section 181. Criminal penalties would apply only to section 181 violations. Section 184 violations would be punished only by loss of patent rights.

Under the newly proposed standard for granting retroactive licenses under section 184, a retroactive license is always available to remedy judgmental errors made without deceptive intent, unless subject matter is involved which the Commissioner determines might be detrimental to national security under section 181. We see no reason, therefore, to excuse from criminal penalties a failure to obtain a license when that failure was not the consequence of an error made without deceptive intent. Accordingly, we oppose enactment of Section 4.

Section 11 of S.1535 would make Sections 2, 3 and 4 effective for all unexpired patents, no matter when granted. Through innocent misunderstandings of the new and more rigorous legal restrictions on transmitting technical information to a foreign country, as established in the Gaertner decision, some patent owners, we understand, may find themselves unable to satisfy the requirements for obtaining retroactive licenses. These disadvantaged patent owners are primarily American businesses, since the provisions of section 184 do not apply to inventions made outside of the United States. The new standard for obtaining a retroactive license, however, will apply to these patents and enable their owners now to avoid civil and criminal penalties. We strongly support this provision, but favor amending it so that amended chapter 17 of title 35 will apply to pending patent applications and to expired as well as unexpired patents. Because there is a six-year statute of limitations for patent infringement actions, patent litigation often involves patents that have expired. Therefore, unless Section 11 is appropriately amended, the applicable laws would differ in suits involving the two types of patents.

Section 5

This Section would clarify an inventor's right to receive a patent by specifying in 35 USC 103 that:

> "Prior art shall not include unpublished information which is developed by the applicant singly or jointly with others, or which is known to the applicant only by virtue of his or her employment."

Prior art is the existing technical information against which the patentability of an invention is judged. Publicly known information is always considered in judging whether an invention is obvious. But a complex and growing body of jurisprudence (begun by In re Bass, 59 C.C.P.A. 1342, 474 F.2d 1976, 177 U.S.P.Q. 178 (1973), and continued in large part by its progeny, including In re Clemens, 622 F.2d 1029, 206 U.S.P.Q. 289 (C.C.P.A. 1980)) regards unpublished information within an organization as prior art if an inventor was aware of it. If unknown to the inventor, however, the same organizational information would not be taken into account in judging nonobviousness. As a consequence, scientists or researchers unaware of such secret organizational information have a better chance of obtaining a patent than those to whom it was known.

We are concerned that this body of jurisprudence will discourage the communication of technical information among scientists and researchers in an organization. It is therefore counterproductive and should be reversed if the efforts of corporate and team research are to be fairly rewarded under the patent system. Neither research laboratories nor technology-oriented businesses conduct research and development in a vacuum. New technology is often developed on the basis of background scientific or technical information known within the organization but unknown to the public. And productive research usually depends on the continuing development and communication of this secret information among researchers and scientists.

Inventions are far less likely to arise from isolated research efforts by those unaware of available background technology and out of communication with others in the organization.

Thus, we believe that a change in the patent laws is needed to assure that unpublished technical information not be regarded as prior art in judging nonobviousness, if that technical information is developed by the patent applicant alone or in collaboration with others, or obtained by the applicant from co-researchers during the course of employment.

Drafting an appropriate provision, however, has proven to be an elusive and complex task. Section 5 is too broad. It is not limited, for example, to exchanges of background information among co-workers in a single organization. Information learned from or transmitted to outsiders could be disqualified as prior art.

Concerned patent law organizations have devoted much effort to the development of a provision that reverses this body of jurisprudence without upsetting other legal principles. On March 15, 1984, the American Intellectual Property Law Association (AIPLA) forwarded to the Chairman of the Subcommittee on Courts, Civil Liberties and the Administration of Justice, of the House Committee on the Judiciary, proposals for amending sections 103, 116 and 120 of title 35 (copy attached). We believe that the amendment of section 103 along the line proposed by AIPLA appears to have the potential of overcoming the problems created by Bass and its progeny in the corporate context. It also may be useful in solving the difficulties addressed by Section 6. I will comment on this and AIPLA's suggestions for amending sections 116 and 120 in my discussion of Section 6.

Section 11 would apply an amended section 103 to patents in force at the time of enactment. We find this proper. A competitor or member of the public could not have known of secret prior art and accordingly would not have acted to his detriment in reliance on this knowledge.

Section 6

This Section would amend 35 USC 116 in regard to the naming of inventors. Section 116 has been asserted by many to require that the invention defined in every claim in an application be invented by all of the named co-inventors. Complying with this requirement is sometimes difficult and at times impossible.

Scientists or researchers in an organization often work on a particular aspect or embodiment of the invention, or on only a portion of the invention, while others work on different aspects, embodiments or portions. Scientists are continually added to a research team, while other scientists leave the team. Concepts and development plans generated through brainstorming cannot always be accurately attributed.

The preparation of patent applications for inventions resulting from team efforts such as these nevertheless requires the attorney to determine the inventorship of each claim to be included in the application. Adequate protection for an invention may require the filing of several applications to cover the separate contributions to all of its aspects, embodiments and portions. Some inventorship problems would require the filing of separate applications that may not be separately patentable. To do otherwise risks noncompliance with 35 USC 116, thereby jeopardizing the rights of all the inventors. These requirements seem especially hypertechnical when in most cases a single organization owns patent rights from all the contributors to the invention.

Admittedly, good faith errors in the naming of inventors, either in an application or a patent, may be corrected. Nonetheless, it is still necessary to determine inventorship. Section 6 would eliminate the need for making these sometimes chancy, complex and time-consuming determinations by specifying that joint inventors need not have contributed jointly to each claim in an application. As we understand the provision, inventors would also be regarded as joint inventors whether or not they physically worked together at the same place or at the same time in developing the invention. Further, joint inventorship would not require that each inventor make the same type or amount of contribution to the invention or that each make a contribution to the subject matter of each claim of the patent. Thus, in our view, the provision would incorporate the rationale in decisions such as SAB Industri AB v. Bendix Corp., 199 U.S.P.Q. 95 (E.D. Va. 1978), and Monsanto Co. v. Kamp, 269 F. Supp. 818, 154 U.S.P.Q. 259 (D.D.C. 1967). The amendment to section 116 proposed by AIPLA in its letter of March 15 to the Chairman of the House Subcommittee expresses these concepts in a clearer fashion than does S.1535, and we support this amendment.

Concern has also been expressed regarding the broad range of Section 6, which could permit patent applicants to "buy up" information that would otherwise constitute prior art by hiring persons, for instance, whose unpublished inventive contributions could otherwise be patent defeating. Such persons would, under Section 6, be considered joint inventors with the patent applicant. In our view, the amendment to section 103 proposed by AIPLA may alleviate this concern because of its provision that the subject matter developed by another and the claimed invention be commonly owned at the time the invention was made.

Like any other applications, jointly-filed applications will continue to be subject to the requirement of 35 USC 121 that an application be directed to only a single invention. Other inventions claimed in the application may each be the subject of a separate (divisional) application. Under existing law, however, the inventive entity in the divisional application must be the same as that in the earlier-filed one, if the divisional application is to be accorded the filing date of the original application. When joint inventors file an application, divisional applications based on it will sometimes have to name different inventive entities, and in these cases the earlier filing date is not available under present law.

To assure that divisional applications receive this earlier filing date, which may be crucial to patentability, an amendment in present 35 USC 120 would be advisable. Here also, AIPLA has made a suggestion which, in our view, may solve this problem.

Section 11 of the bill would apply the new naming requirements for joint inventors in Section 6 to unexpired patents granted either before or after enactment of the bill. We foresee no special difficulty in applying these new provisions retroactively.

In summary, Mr. Chairman, we strongly support the principles of Section 6. We view the amendments proposed by AIPLA as a possible improvement over the language of the Section itself.

Sections 7, 8 and 9

The United States patent laws, unlike those of most other countries, award patent rights to the first inventor. The procedure by which we determine which of rival inventors is the first inventor and therefore entitled to a patent is an "interference" proceeding. These Sections would modify the present interference practice.

Since evidence of the dates of when an invention was conceived and made, and the diligence exercised by an inventor between conception and making, may be necessary to prove first inventorship, interference proceedings can be extremely complex, lengthy, and expensive. For example, the longest interference proceeding (involving polypropylene) consumed over 13 years in the Office alone. While most interferences are not that long, delays in issuing a patent due to lengthy interference proceedings are harmful to both applicants and the public. Applicants are unsure of what rights they will be granted and, consequently, often delay the marketing of their inventions. As a consequence, the public may be harmed by a delay in access to the products involved and to the underlying technology.

Section 7 is an attempt to simplify and speed up interferences. It would require the parties to rely on affidavit evidence in proving inventorship or disproving a rival's claim of inventorship. Presently, parties usually rely on the testimony of witnesses taken by deposition on oral examination. Witnesses are, of course, subject to cross-examination. But testimony in the form of an affidavit, or stipulations, can also be submitted to the Office if the parties agree to do so.

We oppose enactment of Section 7 of S.1535 for several reasons. It would take away any flexibility the Office would have to obtain testimony by the means best suited to the circumstances. Many interferences are presently disposed of through the use of stipulated testimony. The testimony of hostile witnesses cannot effectively be obtained by affidavit. In many cases, it may be desirable to test the credibility of a witness through cross-examination. We believe this is a matter best left to rule making.

Section 8 of S.1535 addresses the filing of interference settlement agreements. When an interference is settled privately by the parties involved, the settlement agreement must be filed with the Patent and Trademark Office. Section 135(c) requires this filing to be made before the interference is terminated. The Commissioner may, on a showing of good cause as to why the agreement was not filed on time, accept the filing of the agreement up to six months after the interference is terminated. The time for filing cannot be extended further, nor can a settlement agreement or any patent involved in the interference be enforced if the agreement is not filed. The penalty for failure to file is unenforceability of both the settlement agreement and any patents involved.

Section 8 of the bill would amend section 135(c) to provide that the penalties for failing to file an agreement would not apply if the failure was the consequence of an error committed without deceptive intent. Section 8 would not have any effect on the kinds of agreements that must be filed.

The Section would further amend section 135(c) by enlarging the Commissioner's authority to accept the filing of a settlement agreement more than six months after the interference is terminated. The Commissioner would still possess statutory authority to demand a showing of good cause as to why the agreement was not earlier filed, and the lateness of filing would remain a factor to be considered in whether to accept the settlement agreement.

The Department of Justice opposes enactment of Section 8 on the ground that its potential benefits are outweighed by the possibility that interference parties may enter into collusive interference settlement agreements. We defer to the Department of Justice on this provision.

Section 9 would permit the parties to an interference to resolve it through arbitration. We strongly support the principles of this Section. Logically, the arbitration provisions of section 294, applicable to the settlement of patent validity and infringement issues, should be extended to interference issues, insofar as this is not already the case. Arbitration provides a faster and less expensive alternative to present administrative or judicial resolution of interferences. Arbitration would spare inventors and the Patent and Trademark Office considerable expense, without encroaching on the right of the public to have interferences correctly resolved.

We have some concerns about the Section, however, as it is worded. The phrase "such award shall be dispositive of the issues to which it relates" in the second sentence of proposed new section 135(d) could be interpreted as suggesting that an arbitration award is binding on other than the arbitrating parties. Clearly, an arbitration award concerning an interference should apply only to the parties, as provided for in the first sentence of present section 294(c). We suggest that the phrase in Section 9 of the bill be deleted and the first sentence in section 294(c) be used instead.

We also suggest that Section 9 be amended to provide that title 9, United States Code, apply to interference arbitrations. Title 9 has been judicially interpreted and is well understood and widely accepted.

We would support an arbitration provision drafted along the lines we suggest with the further suggestion that Section 11 be amended so that arbitration is available to resolve interferences already in progress at the time of enactment.

Section 10

This Section would codify the decision in Lear, Inc. v. Adkins, 395 U.S. 653, 162 U.S.P.Q. 1 (1969), in which the Supreme Court overturned the judicial doctrine of "licensee estoppel." Prior to the Lear decision, a licensee was precluded from questioning the validity of any patent under which he was licensed. The Lear case, however, assures a licensee the right to challenge the validity of any such patent. The Supreme Court recognized the public interest in freedom from invalid patents and, further, that the licensee is the party most able and most likely to challenge validity.

As a result of Lear, however, the licensee is at times able to attack patent validity under conditions completely unfair to the licensor. A licensee, for example, can negotiate the best license terms available from the licensor, accept the contract, and then question patent validity without relinquishing the license. If he wins the validity suit, he can, of course, practice the invention safe in the knowledge that the patent is invalid. If he loses, the licensee merely continues to pay the agreed-upon royalties. He can "have his cake and eat it," risking nothing but attorney's fees. In fact, some courts have even held that it may be possible for the licensee to pay royalties to an escrow account during pendency of the suit over validity, rather than directly to the licensor.

A fairer balance between the rights of the licensor and those of the licensee is needed, without compromising the public interest. New section 295(b) proposed by Section 10, would achieve this balance with a number of straight-forward principles. Either the licensee or licensor could terminate the license once the licensee asserts invalidity in a judicial action. However, the licensee would have to continue paying royalties directly to the licensor (not into an escrow account) unless the license is terminated. Upon termination by either party, further unlicensed practice of the patented invention would subject the former licensee to the infringement provisions of the patent laws.

We support these principles for their basic fairness both to the parties and the public. Various court decisions have upheld such conditions for challenging validity, but they are not widespread or uniform enough to be safely relied upon by licensing parties. A Federal statute is needed.

However, the statute should not be drafted in the form of Section 10, which would increase Federal interference in patent licensing. The correct approach is to do exactly the opposite. Parties should properly be able to negotiate contracts containing provisions, for instance, that a licensor or licensee could terminate the license if the licensee challenged the validity of the licensed patent in a judicial proceeding. The Section should, therefore, assure the parties that any such licensing provisions which they negotiate will not be deemed unenforceable as inconsistent with Federal objectives.

The approach will, I believe, adequately remedy the inequities resulting from the Lear decision insofar as prospective patent license arrangements are concerned. It does, however, leave unanswered the problems faced by those patentees who have entered into license agreements since Lear. We would be pleased to work with the Subcommittee to find an acceptable solution to this problem.

I should point out another avenue open to the licensee which is not addressed by this Section and that is the licensee's option to test the validity of the licensed patent in some instances without resorting to litigation. By instituting a reexamination proceeding in the Patent and Trademark Office under chapter 30 of title 35, the validity of a patent can often be more easily determined and at much less expense to the licensee than litigation would require. Any subsequent judicial review would not involve the licensee and, consequently, in such case the provisions of this Section would not permit the licensor to terminate the license.

As we understand Section 11, it properly would apply the provisions of Section 10 retroactively to patents already granted at the time of enactment. This will assure the resolution of validity challenges under conditions as fair as possible to both parties. Even more important, it will encourage the licensing of patents and the maximum utilization of new technology for the benefit of the public.

The completes my prepared statement, Mr. Chairman. I would be pleased to respond to any questions which you or the other members of this Subcommittee may have.

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AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION
SUITE 203 • 2001 JEFFERSON DAVIS HIGHWAY, ARLINGTON, VA 22202
Telephone (703) 521-1680

March 15, 1984

The Honorable Robert W. Kastenmeier
Chairman, Subcommittee on Courts, Civil
Liberties & the Administration of Justice
U. S. House of Representatives
2137 Rayburn House Office Building
Washington, D. C. 20515

Re: H.R. 4525 and H.R. 4527

Dear Mr. Chairman:

The American Intellectual Property Law Association (AIPLA) has been carefully considering the bills pending before the Subcommittee on Courts, Civil Liberties and the Administration of Justice which affect the patent law and the patent system. AIPLA will present a detailed statement on these bills in the course of the hearings you have scheduled to begin later this month.

During our testimony we will recommend that amendments be made to H.R. 4525 and H.R. 4527. These bills both address serious and current problems in the application of the patent law to inventions resulting from team research carried on in corporations and universities. The amendments do not change, in any way, the intent of H.R. 4525 and H.R. 4527. Rather, we believe the amendments are clarifying and technical in nature.

The amendments follow. I am forwarding them to you in advance of the hearings for your consideration.

H.R. 4525

That Section 103 of Title 35, United States Code, is amended by adding at the end thereof the following:

In addition, subject matter developed by another, which qualifies as prior art only under Section 102(f) or (g) of this title, shall not negative patentability under this section where the subject matter and the claimed invention were commonly owned at the time the invention was made.

H.R. 4527

That Section 116 of Title 35, United States Code is amended by amending the first paragraph to read as follows:

When an invention is made by two or more persons jointly, they shall apply for patent jointly and each (shall sign the application and) make the required oath, except as otherwise provided in this title. Inventors may apply for a patent jointly even though (i) they did not physically work together or at the same time, (ii) each did not make the same type or amount of contribution or (iii) each did not make a contribution to the subject matter of every claim of the patent.

That Section 120 of Title 35, United States Code, is amended to read as follows:

An application for patent for an invention disclosed in the manner provided by the first paragraph of Section 112 of this title in an application previously filed in the United States, or as provided by Section 363 of this title, by an (the same) inventor or inventors named in the previously filed application shall have the same effect, as to such invention, as though filed on the date of the prior application, if filed before the patenting or abandonment of or termination of proceedings on the first application on or an application similarly entitled to the benefit of the filing date of the first application and if it contains or is amended to contain a specific reference to the earlier filed application.

For the purpose of clarity regarding the amendments recommended to H.R. 4527, the additions to the current law are underlined and the deletions are in brackets.

Regards,

Sincerely,

Michael W. Blommer

Michael W. Blommer
Executive Director

Senator MATHIAS. Our next witness is Mr. Donald W. Banner, the president of Intellectual Property Organization, Mr. Bernarr Pravel, president of the American Intellectual Property Association, and Mr. John Dorfman, chairman, Section of Patent, Trademark and Copyright Law, American Bar Association.

I will remind you of our 5-minute rule which we will have to impose. Again, I also remind you that your full statements will appear in the record.

Mr. Banner, do you want to start?

STATEMENTS OF DONALD W. BANNER, PRESIDENT, INTELLECTUAL PROPERTY OWNERS, INC., WASHINGTON, DC; BERNARR R. PRAVEL, PRESIDENT, ACCOMPANIED BY ROBERT B. BENSON, PRESIDENT-ELECT, AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION, ARLINGTON, VA; AND JOHN C. DORFMAN, CHAIRMAN, SECTION OF PATENT, TRADEMARK AND COPYRIGHT LAW, AMERICAN BAR ASSOCIATION, PHILADELPHIA, PA, ACCOMPANIED BY GEORGE WHITNEY, PATENT ATTORNEY, AMERICAN BAR ASSOCIATION, NEW YORK, NY

Mr. BANNER. Thank you, Mr. Chairman.

I think in view of the excellent summary by the Commissioner, I will have no problem staying within my 5 minutes.

IPO would like to congratulate the chairman for introducing S. 1535 and holding these hearings. As you know, what we are interested in is strengthening the patent system in the United States and hopefully in doing that making our country stronger.

We are concerned. We have not been doing things as well as we might, and that is where our concern comes from. As we have indicated in our statement, we seem to be losing some of what we used to be proud of in terms of Yankee ingenuity. We do not seem to be doing as well in those areas that are the cutting edge of technology as we think we should be doing.

In 1983, only three American companies received more U.S. patents than did Hitachi. In 1983, Nissan Motor Co., received about the same number of U.S. patents as General Motors and Ford combined.

In 1983, six of the nine corporations which received the largest number of U.S. patents were foreign or foreign controlled. In 1973, only one of the top nine was foreign or foreign controlled.

Senator MATHIAS. I would agree with you that these are grave facts to ponder. But are they the fault of the patent system or of some other weakness in our society?

Mr. BANNER. I think it is partly the fault of the patent system. I think some of what has happened to us in the past years is that we have neglected a great many areas of our society, and one of them is the patent system.

For example, we have had a judicial climate for patents in the past which has been referred to as one of acid hostility, and I think that is changing. I am happy about that. The Congress, of course, eliminated the Patent Subcommittee, and I think that was a mistake.

We have corrected some of those things, and I think we are moving forward now, and this is an opportunity to increase that step forward.

I will only add to what the Commissioner said with respect to manufacture outside of the United States in section 1 of S. 1535. One of the things, of course, that section 1 of S. 1535 would assist in is providing jobs in the United States.

We are now facing, we are told, a balance of trade deficit of about $100 billion a year, and I think that is rather significant. S. 1535, section 1, would tend to correct that.

In respect to *Deepsouth*, it is a good illustration of that acid hostility. That case was decided at a time when Mr. Justice Jackson, you know, said that the only patent that was valid was one that the Supreme Court had not had an opportunity to get its fingers on.

In *Deepsouth*, we had a situation in which the defendant knew all about the patent, and he knew all about the problems because he had already lost an infringement suit in the United States.

The defendant put everything in the box, and said, "Well, I did not put it all together so there is no problem," and the Supreme Court agreed with him. We do not think that is fair.

On foreign filing licenses, I would only add to what the Commissioner said. We think that the statute has to be changed. We think it is very important that the Congress express its views, and not leave that to administrative agencies.

We have to keep in mind that we are not talking about national security situations. If I make an invention in an oven cleaner and I take it across the bridge to Canada in my briefcase, there is no problem with security regulations. However, if I file a patent application in the United States on an oven cleaner, and I do something wrong by filing a case in Canada with some additional information, my United States patent is invalid, which is a very strange arrangement, I would suggest to you, and very unnecessary. That is what we are talking about. We think the statute ought to be changed.

TEAM RESEARCH

The problem there, as you well know, is the fact that in the United States today that is the way we do a lot of our research. We hope great companies would increase research activity. We could change the team research situation markedly by getting rid of this problem of secret prior art. So we are all in favor of that.

I see my time is up. So I guess I will leave it to my colleagues to continue with this discussion. I just want to say thank you very much for letting us testify.

[The following statement was received for the record:]

PREPARED STATEMENT OF DONALD W. BANNER

Mr. Chairman and members of the Subcommittee:

Thank you for this opportunity to discuss S. 1535 and titles III, IV and V of S. 1841. I am appearing here today on behalf of Intellectual Property Owners, Inc. IPO is a nonprofit association whose members own patents, trademarks and copyrights. Our members include large corporations, small businesses, universities, and individuals.

IPO members are responsible for a significant amount of the research conducted in the United States. Because of the importance of patents in encouraging research and commercial development of new technology, we are deeply interested in having the patent system operate effectively.

Lagging American Technology

IPO believes the United States no longer can afford to neglect matters which affect the climate for national invention and innovation. We have experienced a decline in "Yankee ingenuity." There is no better way to show this than with the statistics on the number of patents issued by the U. S. Patent and Trademark Office.

Patenting statistics show the United States losing ground to its competitors in some of the most active and commercially important technologies--organic chemicals, synthetic resins, telecommunications, and digital logic circuits.

In 1983 six of the nine corporations which received the largest numbers of U. S. patents were foreign or foreign-controlled. In 1973 only one of the top nine was foreign or foreign-controlled.

Only three American companies received more U. S. patents in 1983 than Hitachi--General Electric, IBM and RCA. Nissan Motor Company received about the same number of U. S. patents as General Motors and Ford combined.

In 1973 we were issuing 26 patents to our nationals per 100,000 residents. By 1983 that figure was down to 16 per 100,000 residents. In terms of raw numbers of patents issued to U. S. nationals, we issued 55,000 in 1973 and 37,000 in 1983.

Fifteen years ago the percentage of U. S. patents going to foreigners was about 20 percent. Now it is about 40 percent. The share going to Japanese residents alone has now risen to 15 percent.

Statistics such as these probably were interesting only to patent lawyers at one time. Today more and more people are beginning to realize that such trends have a definite correlation to the number of jobs in our country.

Stronger Patent Incentives Needed

To insure that we maintain our technological leadership, we must provide strong incentives for American firms to create and commercialize technology. One of the most important vehicles for providing such incentives is the patent system. The 17-year exclusive patent right gives incentives to invest in research, development, and commercialization.

These patent incentives are strong only when the patent laws and procedures operate effectively. Several studies, going back at least as far as the President's Commission Report of 1966, have recommended improvements in the functioning of the patent system.

Congress already has made some important improvements. Legislation was enacted in the 96th Congress which authorizes the Patent and Trademark Office to reexamine patents after they have been issued. Legislation in the 97th Congress established the Court of Appeals for the Federal Circuit to help bring uniformity and certainty to Federal court decisions in patent cases. These are significant reforms, but much remains to be done.

IPO commends the Chairman for taking the initiative to propose S. 1535. The bill contains somewhat technical but nevertheless very important provisions for modernizing and simplifying the patent code and strengthening the rights of patent owners. IPO believes enactment of S. 1535 would bolster the incentives for American firms to engage in research and development. We strongly support every provision of S. 1535 except for one provision on interference proceedings that I will mention.

IPO also favors enactment of titles III and IV of the Administration's bill, S. 1841. Titles III and IV concern intellectual property licensing and the misuse doctrine. Titles III and IV would add predictability to the law governing licensing practices. By providing more certainty as to the permissible scope of licensing practices, the bill would increase the value of patents to patent owners. This would strengthen the incentives that patents provide to engage in research and development.

Turning now to specific provisions of the legislation, I shall discuss S. 1535 first. Although we are not wed to any particular language for the bill, an appendix to my statement lists certain refinements in language which we believe are improvements. We have obtained some of these suggestions from other organizations which are supporting the bill.

Manufacture Outside the United States

Section 1 of S. 1535 eliminates two loopholes in existing patent law that encourage manufacture of patented inventions outside the United States. The first part of section 1 makes it infringement to import into the United States a product manufactured abroad using a process patented in the United States. The remedies available to the patent owner through this provision would strengthen the patent system for the benefit of U. S. patent owners.

Offshore production using patented processes has long been in need of a remedy in the patent law. Such a remedy was recommended in the 1966 report of the President's Commission on the Patent System. Our major trading partners have provisions in their patent laws similar to the subject proposal. Although the Tariff Act already makes it a potential unfair method of competition to import a product made abroad by a patented process, the Tariff Act's remedies are limited.

S. 1841, in title V, also addresses process patent infringement, but we prefer S. 1535, with the refinements shown in the appendix. S. 1841 states it will be presumed that a product was made by a patented process if (1) a substantial likelihood exists that the product was produced by the patented process and (2) the patent owner has exhausted all reasonably available means in the foreign country to establish that the product was made by the patented process. Although we agree that courts should presume in appropriate situations that the product was made by a patented process, we are concerned that the requirement to exhaust discovery or other procedures abroad could be unduly expensive for patent owners. We believe the presumption should apply whenever the first requirement of S. 1841 is satisfied--namely, whenever a substantial likelihood exists that the product was produced by the patented process.

We are aware that the office of the United States Trade Representative has expressed concern that section 1 of S. 1535 would violate our country's obligation under the General Agreement on Tariffs and Trade (GATT) not to discriminate against foreign-made products. The office of the Trade Representative apparently believes that foreign products are treated less favorably than domestic products under the bill, because there is no remedy under the bill against the use or sale of a product manufactured in the United States by a process patent.

If the Committee should decide that the GATT requires the broadening of the legislation to cover use or sale of products manufactured in the United States by a process patent, S. 1535 could be broadened by deleting the phrase "in another country" in section 1. We do not favor this change, however, unless the GATT in fact requires it.

The second part of section 1 of S. 1535 makes it infringement to supply components of a patented process for final assembly abroad, if supplied for the purpose of avoiding the patent. This would change the present law as interpreted by the United States Supreme Court in 1972 in the Deepsouth case. In that case the Supreme Court noted that legislative action is needed if a patent owner is to have a remedy in a circumstance where the components of an invention are made in the United States and final assembly is performed offshore for the purpose of avoiding the United States patent.

The existing patent law on this point is unfair. It permits a subterfuge. The law should not permit substantially all the manufacturing activity to take place in the United States and yet allow the patent to be avoided by a technicality.

Foreign Filing Licenses

The existing requirements for obtaining a license from the U. S. Patent and Trademark Office before filing a patent application abroad cause enormous volumes of paper to flow through the Office on often trivial material. Applicants have to obtain licenses from the Patent and Trademark Office in many cases where no national security purpose conceivably could be served.

We believe sections 2 to 4 of S. 1535 preserve protection for national security while reducing the burdens on users of the patent system. Section 2 allows supplementary material for a patent application to be filed in a foreign country without a license from the Patent and Trademark Office, provided the supplementary material is an "illustration, exemplification, comparison, or explanation" of subject matter already licensed. The "illustration, exemplification. . ." language relaxes the burdensome nature of the licensing requirements for supplementary material.

We understand that the Patent and Trademark Office is issuing final rules this week changing its procedures under existing law.

We compliment the Office on using its rulemaking authority to alleviate the long-time burdens on patent applicants, but we still recommend adding the "illustration, exemplification. . ." passage, or similar language, to the statute. This will avoid the possibility of burdensome requirements being reimposed on patent applicants at some future date without Congressional approval.

Section 2 of S. 1535 relaxes the "inadvertence" standard that must be met in order to obtain a license from the Patent and Trademark Office retroactively. The bill substitutes "through error and without deceptive intent." We support this change because it will make it possible for an applicant who has failed to comply with the licensing requirements deliberately but in good faith to obtain a license retroactively. Similar language is also added by section 3 of the bill.

In addition, section 4 of S. 1535 exempts applicants from criminal penalties for failure to obtain a license. We support this provision, because it eliminates a penalty which is too harsh for failure to comply with regulations which cover primarily subject matter unimportant to national security. Section 184 of the patent code would still provide criminal penalties for disclosing subject matter which has been ordered to be kept secret.

Team Research

Section 5 of S. 1535 provides that unpublished information known only within the inventor's organization (that is, so-called "secret prior art") may not be used to defeat the granting of a patent. Today confidential technology developed by one member of a corporate or university research team can be used against the invention of another team member. The present state of the law penalizes larger organizations which have teams of inventors working on research. S. 1535 would put an end to this discrimination. The appendix to my statement contains a draft prepared by interested patent lawyers which we believe represents an improvement in language over section 5 in the original bill.

Section 6 of S. 1535 makes clear that two or more inventors may obtain a patent jointly even though each inventor has not contributed to every "claim" of the patent. This change complements section 5. Inventors often work on a particular aspect of an invention while someone else works on different aspects. It is often difficult or impossible to draft the claims of the patent so that each co-inventor has his contribution recited in each of the claims.

Section 6 follows those court decisions which have held that neither the statute nor any rule of the Patent and Trademark Office requires each claim in the patent to cover subject matter which was invented through joint efforts of all the inventors named in the patent. The appendix sets forth suggested language which refines section 6 as originally proposed.

Patent Interferences

Sections 7 to 9 of S. 1535 relate to patent interferences. Interferences are administrative proceedings in the U. S. Patent and Trademark Office for deciding which of two or more rival inventors made an invention first.

IPO recommends that section 7 of the bill be dropped. We believe most supporters of the bill are agreeable to dropping it. We sympathize with the objective of section 7, which was to simplify interferences, but believe it would be undesirable to rely on affidavit evidence in interferences without providing a right to cross examine the person making the affidavit.

We support the provisions in sections 8 and 9 relating to interferences. Under section 8 the penalty for failing to file a settlement agreement in the Patent and Trademark Office would not apply if the failure was "through error and without deceptive intent." This is the same standard proposed earlier in the bill for judging whether or not a patent owner is entitled to a retroactive license to file an application abroad.

Section 8 also deletes the six-month time limit on the Commissioner's discretion to excuse failure to file a settlement agreement, giving parties a greater opportunity to comply with the filing requirement. We can see no reason to limit the Commissioner's discretion to a six-month period. The bill would still preclude the Commissioner from accepting a late filing except upon a showing of good cause for failure to file on time.

Section 9 authorizes parties to arbitrate issues arising in patent interferences. In 1982 Congress enacted section 294 of the patent law, which makes arbitration available for settling disputes over validity and infringement. It is logical to extend arbitration to patent interference issues as well. Arbitration is a quicker and cheaper alternative to other forms of dispute resolution in many cases.

License Agreements

Section 10 of S. 1535 is one of the key provisions of the bill. We strongly support it. The section allows either party to terminate a patent license agreement after the licensee has asserted in court that the patent is invalid. The section also makes the licensee liable for royalties until the license has been terminated.

Before the Supreme Court's 1969 decision in Lear v. Adkins, a licensee was "estopped" from questioning the validity of a patent under which he was licensed. The Supreme Court stressed the public interest in allowing the licensee to challenge patent validity, because the licensee often is the party with the most incentive to mount a challenge. Unfortunately the Lear opinion and subsequent lower court interpretations left the licensor in an unfair bargaining position. Moreover, conflicting rulings by lower courts have caused confusion over how to apply the Lear doctrine to particular fact situations.

Under existing law, an unscrupulous licensee can negotiate a license on favorable royalty terms and immediately begin litigation on the patent while continuing to enjoy the benefits of the license. The licensee can withhold payment of all royalties during the period of litigation without giving up the license.

This may result in a licensor becoming cash starved during the pendency of the litigation. This can be particularly unfair for a licensor who was forced to license the product in the first place because the licensor did not have enough capital to produce the invention.

We understand the Administration is recommending recasting the bill so that it would merely restore the freedom of the licensor and the licensee to negotiate for the rights mentioned in S. 1535, instead of guaranteeing the rights to every party. It is said that this approach would decrease federal interference in patent licensing.

Although we agree that ordinarily the federal government should not interfere with freedom of private parties to negotiate contracts, we do not perceive any advantages in the approach recommended by the Administration in this case. The federal government interfered with patent licensing when the Supreme Court decided Lear. We can see no way to decrease federal interference significantly at this point without overruling the Lear holding.

Effect on Existing Patents

Finally, we support in principle section 11 of S. 1535, which provides that the bill will apply to United States patents already granted, as well as to patents issued after enactment. In order for the bill to have maximum effect in strengthening the patent law, it must apply to patents already in force. Given the urgent need to provide incentives to strengthen America's technological leadership, we cannot afford to wait years for the bill to have an impact.

On the other hand, we believe some modified language may be needed in section 11 of the bill to prevent injustice to parties who have made investments or taken positions relying on the existing state of the patent law. Language should be added to section 11 to insure that the effects of the bill are equitable insofar as existing patents are concerned.

Titles III and IV of S. 1841--Intellectual Property Licensing

Titles III and IV deal with intellectual property licensing. We support their enactment because we believe they would encourage R & D investment.

Titles III and IV would add predictability to the law governing licensing practices. They would eliminate judicially created legal doctrines that discourage use of potentially procompetitive licensing arrangements. They would benefit small businesses especially, because small businesses often need to license technology from others on terms which enable a lower royalty to be charged.

We favor requiring intellectual property licenses to be evaluated under the "rule of reason" as provided in title III. Although the rule of reason approach is already followed for intellectual property licenses, we believe it would be beneficial to incorporate it into the statute. This would ensure that courts would not strike down licenses without economic analysis. It would also give businesses confidence that courts will not return to the hostile attitude toward licensing that some courts displayed in the 1970's and earlier.

We also support limiting recovery in suits based on intellectual property licenses to "single" damages as provided in title III. Treble damages are an unduly harsh remedy to impose on licensors. The plaintiff in an antitrust suit challenging a license ordinarily is the licensee who has been aware of the allegedly anticompetitive restriction from the beginning.

We urge enactment of title IV. Under title IV, courts could not refuse to enforce a patent or copyright on the ground that a licensing practice suppressed competition unless the practice amounted to a violation of the antitrust laws. Title IV would eliminate a hodgepodge of arbitrary rules developed by courts during the era when courts were hostile to licensing.

We believe the scope of title IV may need clarification through redrafting or through explanation in a committee report. Title IV sets forth five specific categories of licensing practices which are not to be considered misuse unless the conduct violates the antitrust laws. The five categories are followed by a sixth, catchall category reading, "otherwise used the patent allegedly to suppress competition."

The first five categories may raise questions of interpretation. For instance, category (5) reads "refused to license the patent to any person." Does this imply, incorrectly, that under existing law a patent owner can be guilty of misuse by refusing to license the patent to anyone whatsoever? This needs correction in the bill or legislative history.

We also suggest it needs to be made clear that category (6) covers every type of licensing practice which allegedly suppresses competition, and that category (6) encompasses all the practices recited in categories (1) to (5). This should minimize problems in interpreting the scope of (1) to (5).

With these clarifications, we believe title IV would substantially improve the law governing patent licensing.

* * *

I appreciate the opportunity to present our views and I will be pleased to answer any questions.

Summary

- IPO supports enactment of S. 1535 and titles III and IV of S. 1841 because they would strengthen incentives the patent system provides for R & D.
- .Statistics on U. S. patents show a decline in "Yankee ingenuity":

--In 1983 six of the nine corporations which received the largest numbers of U. S. patents were foreign or foreign-controlled. In 1973 one of the top nine was foreign or foreign-controlled.

--In 1983 Nissan Motor Company received about the same number of U. S. patents as General Motors and Ford combined.

* S. 1535 would modernize and simplify the patent code. The bill:

--Eliminates two loopholes that encourage manufacture of patented inventions outside the United States.

--Reduces burden of requirement to obtain a license from Patent and Trademark Office before filing abroad.

--Modernizes law on whether unpublished information known only within a corporation or university and developed by one inventor can be used to defeat a patent to another inventor.

--Amends law relating to patent interference proceedings by relaxing penalties and allowing arbitration.

--Strengthens rights of licensors in patent license contracts.

* Titles III and IV of S. 1841 would provide certainty as to the permissible scope of patent licensing practices.

APPENDIX: LANGUAGE REFINEMENTS FOR S. 1535 AND TITLE IV OF S. 1841 SUGGESTED BY INTELLECTUAL PROPERTY OWNERS, INC.

1. In section 1 of S. 1535, add the following at the end of proposed section 271(e) of the patent code: ",if the product is imported, used or sold during the term of such process patent."

   Comment: Makes clear that the importing, using or selling must take place during the term of the process patent for there to be infringement.

2. Add a new section to S. 1535 amending section 287 Title 35, United States Code, by adding the following at the end of section 287: "No damages may be recovered for an infringement under section 271(e) of this title unless the infringer was on notice that the product was made by a process patented in the United States."

   Comment: Requires the infringer to have actual notice before damages can be recovered, since the infringer may not be in a position to investigate possible infringement.

3. Add a section to S. 1535 inserting a new section 295 in title 35, United States Code, reading as follows: "In actions alleging infringement of a process patent based on importation, use or sale of a product produced by the patented process, if the court finds that a substantial likelihood exists that the product was produced by the patented process, then the product shall be presumed to have been so produced, and the burden of establishing that the product was not produced by the process shall be on the party asserting that it was not so produced."

Comment: Similar to section 503 in title V of S. 1841, but omits requirement to exhaust "all reasonably available means through discovery or otherwise to determine the process actually used in the production of the product. . ."

4. Replace section 5 of S. 1535 with the following language: "Section 103 of title 35, United States Code, is amended by adding at the end thereof the following: 'In addition, subject matter developed by another which qualifies as prior art only under sections 102(e), (f) or (g) of this title shall not negate patentability, when the subject matter and the claimed invention were commonly owned at the time the invention was made.

   Comment: Differs from some other drafts by referring to section 102(e) as well as (f) and (g).

5. Amend section 6 of S. 1535 by substituting the following: "(a) Section 116 of title 35, United States Code, is amended by amending the first paragraph to read as follows: 'When an invention is made by two or more persons jointly, they shall apply for patent jointly and each make the required oath, except as otherwise provided in this title. Inventors may apply for a patent jointly even though (i) they did not physically work together or at the same time, (ii) each did not make the same type or amount of contribution or (iii) each did not make a contribution to the subject matter of every claim of the patent.'"

   "(b) Section 120 of title 35, United States Code, is amended to read: 'An application for patent for an invention disclosed in the manner provided by the first paragraph of section 112 of this title in an application previously filed in the United States, or as provided by Section 363 of this title, by an inventor or inventors named in the previously filed application shall have the same effect, as to such invention, as though filed on the date of the prior application, if filed before the patenting or abandonment of or termination of proceedings on the first application or on an application similarly entitled to the benefit of the filing date of the first application and if it contains or is amended to contain a specific reference to the earlier filed application.'"

   Comment: Elaborates on the definition of joint inventorship in 35 USC 116 and provides in 35 USC 120 that a continuing application can obtain the benefit of an earlier application naming different joint inventors.

6. Delete section 7 of S. 1535, which relates to use of affidavits to establish dates of invention in patent interference proceedings.

   Comment: IPO supports efforts to simplify interference proceedings, but believes affidavit evidence is not appropriate without a right to cross examine the person making the affidavit.

7. Amend section 11 of S. 1535 to read as follows: "The amendments made by this act shall apply to all United States patents granted before the date of enactment of this act and to any United States patent granted on or after such date."

   Comment: Makes bill apply to all patents on which suits can still be brought, even if patents are expired. Also makes clear that the bill applies to patents granted on the day of enactment as well as after such date. (Further amendment of this section may be needed in order to limit the retroactive effect of certain sections, to avoid injustice to parties who have taken positions relying on existing patent law.)

8. Amend section 401 in title IV of S. 1841 by (1) deleting the paragraphs which redesignate existing subsections of 35 USC 271; and (2) amending the new subsection proposed for 35 USC 271 to designate it 271(e) instead of 271(d).

Comment: Existing subsection 271(d) is related to both of existing subsections 271(b) and 271(c). S. 1841, by redesignating existing 271(d) as 271(c)(2), might cause confusion about the relationship among the subsections.

Senator MATHIAS. Mr. Pravel.

STATEMENT OF BERNARR R. PRAVEL

Mr. PRAVEL. Mr. Chairman, we thank you for permitting our association to be here today. With me is Robert B. Benson, the president-elect of the American Intellectual Property Law Association. We recently changed from the name we formerly had, American Patent Law Association.

In view of our written statement, the chairman will be aware that we support these bills with the exception of section 7 of S. 1535, which is the provision that relates to the requirement to use affidavits to prove priority of invention in interferences in the Patent Office.

We oppose that. We believe that there are better forms of producing evidence, and it certainly should not be mandatory to use an affidavit.

We support sections 2, 3, 4, 8, 9, and 10 of your bill, Senator Mathias, S. 1535, as written. We do have some suggested amendments to some of the other sections, both in terms of substance and perhaps in terms of technical clarity.

For example, section 1 which deals with the infringement by the importation of a product made by a process patented in the United States. We have three proposed amendments which we consider to be important.

One, the effective period of the provision should relate to the term of the patent. It is not spelled out in the section at this time. We also believe that, in all fairness, when an importer of a product brings a product into the United States that the damages should be limited so that he is not subject to damages until he has been put on notice that the product is made by a process which is patented in the United States.

Also we have spelled out in detail the effective term and to which patents section 2 would apply and that it would not apply to products that were imported into the United States before the date of the act.

The other part of section 1, the amendment to section 271 (f) of title XXXV, raised by the *Deepsouth* decision, this provision as it is now worded requires a proof of infringement plus proof that the person who is supplying the material components for the assembly outside the United States intended that those components be combined to infringe the patent.

The requirement, however, that the patent owner prove that he did this knowing that there would be infringement, we believe, is an additional requirement that is unnecessary and that would virtually nullify the effectiveness of the act because of the complexities of such proof and the knowledge within the person supplying those components.

We, therefore, would delete the word "knowing" from that section.

With respect to sections 2, 3, and 4, support them as written. We would comment, however, with respect to a suggestion by the Justice Department proposal that the retention of the criminal penalty for a violation of section 184 should be retained. It is our position that there is an adequate civil penalty by the taking away of that patent from the patent owner which is adequate and it is unnecessary to have a criminal penalty where there would not be a security risk by the disclosure of the subject matter by the foreign filing. We would, therefore, support those sections as written.

Section 5 of the act deals with this matter of research and development within corporations, universities, and other group efforts. Our amendments which we have submitted limit and more accurately define, we submit, the sections of prior art which should be excluded from consideration.

We believe the present wording is too broad and it excludes prior art which should be retained as prior art, whereas the proposed amendments which we have submitted confine the prior art which is excluded to those sections which are clearly defined in title XXXV now, sections 102(f) and 102(g).

Our time is up, Senator. We thank you very much for the opportunity. If there are any questions, we would be glad to attempt to answer them.

[The following statements were received for the record:]

PREPARED STATEMENT OF BERNARR R. PRAVEL

The American Intellectual Property Law Association (AIPLA) is a national society of more than 4800 lawyers engaged in the practice of patent, trademark, copyright, licensing, and related fields of law affecting intellectual property rights. AIPLA membership includes lawyers in private, corporate, and government practice; lawyers associated with universities, small business, and large business; and lawyers active in both the domestic and international transfer of technology.

We commend this Subcommittee for undertaking this most important series of hearings which directly relate to the alarming decline in American industrial productivity and innovation. We support the enactment of S. 1535, with the single exception of Section 7, and Titles III and IV of S. 1841. These initiatives will materially assist American creators of intellectual property.

There are facts and impressive statistics known to the Members of this Subcommittee which demonstrate that U. S. technical superiority in the world is now threatened. We in AIPLA know from first-hand experience that competition in world markets in high technology products and goods produced by advanced technological methods and processes is growing stiffer for American business each year. This declining ability to compete is clearly having a serious impact on American exports and imports and is contributing to America's massive trade deficit.

Section 1

Section 1 of S. 1535 corrects two anomolies in the patent law which weaken the ability of American patent owners to compete in international markets. While these two amendments have implications involving export and import trade, both only affect domestic patent rights. U. S. patents only confer rights within the United States.

Process Patent Rights

Many U. S. patents cover processes for making a product. Under those patents, the patentee has the right to exclude others from using the patented process in the U. S. A process patent owner can benefit from his invention by using it himself to make and sell a product or by licensing others to do so.

If a patent owner can obtain a patent on the product produced by a process, the protection afforded by this Section would be unnecessary because the patent owner could then sue for infringement of the product claims of the patent. However, in many cases, particularly involving chemicals, a patent cannot be obtained on the chemical or product as such because the product or chemical occurs in nature or is otherwise old and therefore is not patentable under 35 U.S.C. §102. However, the naturally occurring or old product is frequently not economically obtainable or it cannot be practically or competitively made using old processes. For that reason, the process which is new and patentable is the only practical and competitive way to make the product available to the public. Therefore, the process patent protects a new practical way to obtain the product so that the product is available to the public on a commercial basis.

To evade the process patent owner's rights, unscrupulous persons may now use the protected process outside of the U. S. and import the resulting product into this country. This practice unfairly undercuts American inventors' rights and promotes unfair foreign competition in domestic U. S. markets.

This activity now constitutes an unfair method of competition within the scope of the Tariff Act [19 U.S.C. §1337(a)]. However this cause of action before the International Trade Commission is of limited use to aggrieved process patent owners. Not only must patent infringement be proved, but also the Commission must determine that the importation tends to "destroy or substantially injure an industry . . . in the United States" (19 U.S.C. §1337). Also, an Executive Order of exclusion must be obtained. In addition, the patent owner can only obtain this order of exclusion, and cannot obtain damages for past infringement.

The patent laws of the other industrialized countries do not permit this type of evasion of process patent owner's rights. Foreign manufacturers are protected and American manufacturers are not. Finally, we note that this change in U. S. law was recommended by President Johnson's Commission on the Patent System in 1966.

We recommend that two amendments be made to Section 1 regarding process patent rights. The first amendment is to insert on page one, line 7 of S. 1535, after the words "United States" the words "during the term of the patent therefor." The infringing acts in this new section are the importing into or sale or use within the United States of a product made by the process patented in the U. S. The amendment makes clear that the infringing acts must occur in the U. S. during the term of the U. S. patent being infringed.

The second amendment is to add at the end of Section 287 of title 35 the following:

> No damages may be recovered for an infringement under Section 271(e) of this title unless the infringer was on notice that the product was made by a process patented in the United States.

Section 286 of title 35 provides that damages for patent infringement may be recovered for a period of six years prior to filing of the complaint or counterclaim for infringment.

The law in Section 287 provides a means for giving notice to the public that a product is protected by a patent. This form of public notice is met by affixing the word "patent" or "pat." and the patent number to the product, its package, or its label. If the patentee fails to mark, damages for infringement may be recovered only after the infringing party has received actual notice of infringment. Damages are limited to infringing activity occuring after the notice. However, the law is equally clear that failure to mark does not limit damages for infringement of a process patent. The amendment we propose takes into account these two principles and will have the following effect. If the party manufacturing the product abroad by use of the patented U. S. process is also the importer, seller, or user of the product within the U. S., no limitation on liability for infringement will apply. That party is deemed to be "on notice" of the patented process in the same way as the party would be if the process was infringed by the party within the United States. However, if a party is committing the infringing acts and is dealing at arm's length with the manufacturer of the product, it would be unfair not to limit liability for infringement because the product in question will not be marked. Such a party must be put "on notice" and liability for damages will attach only after the date of notice. The notice required will be actual notice according to the terms and interpretations of existing Section 287 in a nonmarking situation.

Product Patent Rights

The Supreme Court in a 5 to 4 decision in Deepsouth Packing v. Laitram Corporation, 406 U.S. 518 (1972) created what amounts to a "loophole" in the patent law, which the Court said must be corrected by Congress. While many legal commentators believe the case was wrongly decided [e.g. "Operable Versus Substantial Assembly of Patented Combinations:

A Critique of Deepsouth v. Laitram," Charles Kerr, 26 Stanford Law Review 893 (1974)], the precedent stands.

Laitram patented and manufactured a machine to devein shrimp. Deepsouth, a competitor, manufactured a similar device. Laitram sued Deepsouth for patent infringement and the district court found that Deepsouth had infringed Laitram's patent. In a subsequent clarification of its holding, the district court ruled that Deepsouth could continue to manufacture the machine so long as the machine was not completely assembled in the U. S. and was being made for export only. The Fifth Circuit reversed and ruled that substantially assembling the machine so that it could be made operable in a foreign country constituted infringement of Laitram's patent on the machine. The Supreme Court reversed the Fifth Circuit and reinstated the district court decision.

We believe that a patentee, such as Laitram, should have the right to benefit from his invention. The holding in the Deepsouth Case enables domestic copiers to circumvent the protection afforded by the patent laws by taking simple evasive production and marketing tactics. This loophole in the law negatively affects the patentees' ability to export his invention or license others to do so. Defeating the expectation of innovative companies of benefitting from export trade is a severe disincentive, serious injustice, and is especially contrary to current economic policies designed to reduce United States trade deficits.

We recommend that the word "knowing" be deleted from line 3 on page 2. Section 271(f) like existing Section 271(a) defines activities which constitute direct infringement of a patent. If a patentee brings suit pursuant to Section 271(a), he must prove that the alleged infringer committed the infringing acts. A judge or jury decides whether or not the patent was infringed. Section 271(f) as drafted would require that the patentee not only prove that the alleged infringer committed the infringing acts and intended the combining of the material components outside of the U. S. but also that he did so "knowing" that components when combined would "be an infringement of the patent." The existence of this state of mind in the alleged infringer would be extremely difficult to prove. Proof of infringement involves both facts and law and cannot be known until after a court determination. Therefore, for the patentee to prove that the alleged infringer "knew" would be an easy escape for the unscrupulous infringer and would effectively nullify the section. But more importantly, the reason 271(f) should be added to the law is that patent rights should be protected whether an infringer finally assembles the infringing product in the U. S. or arranges to have it done in a foreign country. We see no reason to require a higher burden of proof in one set of circumstances and not the other.

Sections 2, 3, and 4

These sections contain amendments to provisions of Chapter 27 of Title 35. That Chapter is designed to prevent the transmittal of information in patent applications to foreign countries which may "be detrimental to the national security" (35 U.S.C. 181). Approximately 7 percent of the patent applications filed by Americans each year are in a class which requires scrutiny by the PTO and other Government agencies to determine whether secrecy orders should be issued. The problem is that the licensing regulations, which are burdensome on the PTO and to applicants, and the penalties, which are harsh, apply to the 93 percent of the applications which clearly do not affect national security. The amendments proposed by these sections of the bill affect only the "non-national security" applications and in no manner affect or weaken the ability of the PTO to meet its vital legal responsibility to issue secrecy orders when necessary.

An inventor who wishes to apply for a patent abroad within six months of the date of filing a U. S. application must receive a license from the PTO to do so. The term "application" is defined in Section 184 to include "modifications, amendments, or supplements thereto, or divisions thereof."

Section 184 also provides that in the case of an application which does not affect national security a retroactive license may be granted to an applicant who has filed abroad without a license if the applicant acted "inadvertently." Paragraph (1) of Section 2 would change the standard of "inadvertently" to require that the applicant acted "through error and without deceptive intent."

We believe that Section 184 authorizes the Commissioner to grant retroactive licenses to allow for equity when an applicant has made an unintentional error. The reason that equity is required is that the penalty for filing abroad without a license is that the corresponding U. S. application is declared invalid. The need for a more flexible standard was made clearly evident by the case of In Re Gaertner, 604 F. 2nd 1348 (1979). The attorney for the applicant in a complicated situation decided that a foreign filing license was not required based on his interpretation of the facts in the case and judicial interpretations of the Section 184 definition of "application." The Commissioner's position was that he did not have the right to grant a retroactive license because the decision by the attorney which was ultimately found to be incorrect was not "inadvertent," but was consciously made. The patent application was, therefore, declared invalid. The CCPA, in upholding the PTO, stated: "Neither Gaertner nor this court has authority to determine whether the disclosure abroad of . . . would be detrimental to national security. Section 184 assigns that right and duty to the PTO." The bill would provide the Commissioner a more flexible and reasonable standard so that fairness is possible in all cases of unintentional error.

We emphasize that the more flexible standard only applies to errors in cases which do not affect national security.

Paragraph (2) of Section 2 amends Section 184 to provide that filing licenses are not required to file "the illustration, exemplification, comparison, or explanation of subject matter specifically or generally disclosed" in an application already authorized to be filed abroad. This amendment will eliminate the need to obtain a foreign filing license on information which adds nothing substantive to subject matter of the patent application which has no national security implications and which has already been licensed for foreign filing. The PTO has already promulgated regulations which authorize the Commissioner to grant a general license which eliminates the need for an additional specific license in this type of situation. However, we believe this change in Section 184 is highly desirable in view of the fact that criminal liability and a declaration of patent invalidity potentially arises for failure to comply with these license requirments.

Section 3 of the bill conforms Section 185 to the amendment made by the bill to Section 184. Section 4 amends Section 186 to provide that criminal penalties may not be imposed on an inventor who fails to meet licensing requirements in cases which do not involve national security. The inventor is subject to loss of patent rights in the U. S. for a violation of licensing requirements. Adding criminal sanctions to that is an unduly severe penalty.

Section 5

This section contains an amendment to Section 103 of Title 35. Section 103 is a key provision in Title 35 in determining what is patentable. When the subject matter sought to be patented is not identical to the prior art, Section 103 requires the Patent and Trademark Office or the court to determine whether the subject matter would have been "obvious."

This amendment does not change the test for obviousness set forth in Section 103. It merely limits the subject matter which can be considered "prior art" under Section 103.

Such limitation on the "prior art" is necessary because of specific problems which arise in conjunction with research and development projects within corporations, universities and other business entitites where several people or a group of people are involved in such research and development.

The problem cured by this amendment to Section 103 is focused on in two cases by the Court of Customs and Patent Appeals (now merged into the new Court of Appeals for the Federal Circuit). Those cases are In Re Bass et al, 177 U.S.P.Q. 178 (C.C.P.A. 1973) and In Re Clemens et al, 206 U.S.P.Q. 289 (C.C.P.A. 1980).

In the Bass case, there was a first inventor, Jenkins, who invented a tapered bar screen. Jenkins was also a co-inventor with two other parties, Bass and Horvat, on a combination apparatus that included the Jenkins tapered bar screen. Both of the inventions were assigned to a company by whom all three of the inventors were employed.

In the Clemens case, there were two inventions, one made by an employee, Barrett, and the second by a group of three co-employees including Clemens. As in Bass, both inventions were assigned to the employer of the co-employees involved in the two inventions.

In both Bass and Clemens, the CCPA construed Section 102(g) and Section 103 of Title 35 so that the prior invention of one employee could be "prior art" to the second invention of co-employees and thus be subject to the "obviousness" test of Section 103. The Bass decision was by a divided court, with a two-judge concurring opinion which amounted to a dissent. Wording used in both cases implicated Section 102(f) as well as Section 102(g).

The result of Bass and Clemens is that the earlier invention by an employee is treated under Section 102(g) or possibly under 102(f) as prior art to a later invention made by a co-employee(s) who is involved in the first invention or otherwise has knowledge of the first invention by reason of their mutual employment and usually by reason of joint or overlapping research and development work.

Such treatment of an invention by a co-employee as prior art under Section 103 is a hindrance and an impediment to joint research and development within a corporation, university or other business entity. In effect, it inhibits co-employees from communicating with each other about their research work on projects in the same organization, even though their work may be related. Such restraint on communication in research is unhealthy and contrary to the purpose of the patent laws which is to promote progress in science and the useful arts. Such blocking of communication between persons working on research and development is a negative influence which does not serve any useful purpose.

Further, under the Bass case, the prior inventor of a component is inhibited from cooperating with others to make additional inventions within the same reserach and development organization.

Additionally, under the present state of the law, to avoid the first invention from being treated as prior art as to later modifications and improvements, the employer must either keep the first invention secret until the research and development project is completed, or run the risk of losing patent protection on the later modifications and improvements by the court holding them to be "obvious" from the first invention. Such a restraint thus could delay the patenting of inventions and the ultimate availability to the public.

Thus, the amendment to Section 103 of Title 35 is an important step in the encouragement of research and development within organizations by removing statutory obstacles to disclosure and cooperation between co-employees working in such organizations.

We recommend that Section 5 be redrafted as follows:

> In addition, subject matter developed by another which qualifies as prior art only under sections 102(f) or (g) of this title shall not negative patentability under this section when the subject matter and the claimed invention were commonly owned at the time the invention was made.

We believe that Section 5 as drafted in addition to modifying subparagraphs (f) and (g) of Section 102 of Title 35 might be interpreted as eliminating other prior art bars. Also, some of the words in Section 5 are unnecessarily vague. The purpose of the amendment is to precisely define the needed remedy. We have attached as an appendix a full discussion of the effect of the proposed amendment which may be useful to the Committee in establishing legislative history.

Section 6

The amendments to Section 116 of Title 35 should have a twofold purpose: (1) to permit inventors to be joined in a single patent application, even though they may not have contributed to every claim in the application, and (2) to clarify the criteria for joint inventorship. The Section as currently drafted achieves only the first purpose. Therefore, we recommend that an amendment be made to Section 6 of the bill. The amendment is specified below. The amendments to Section 6 are complimentary to the amendments to Section 103, and recognize the realities of team research in a modern organizational environment.

With respect to the first purpose, although the present statute is silent as to the requirement that each inventor joined in the patent application must have contributed to the invention recited in each claim thereof, judicial interpretations can be found supporting either side of the coin. Thus, in support of such a requirement are Worden v. Fisher, 11 F. 505, C.C.E.D. Mich. 1882, and Stewart v. Tenk, 32 F. 665, C.C.S.D. Ill. 1887. That this requirement continued under present Section 116 is shown by a footnote In Re Sarett, 327 F. 2d 1005 (C.C.P.A. 1964). In that case, an application by a sole inventor was rejected for double patenting over a patent issuing to joint inventors, including that same person. Judge Rich, speaking for the Court, states:

> It should be clear that the patent could not legally contain a claim to Sarett's sole invention under existing law because it would not have been the invention of the joint patentees.

Of interest to the present proposal to modify the first paragraph of Section 116 is that Judge Rich goes on to state:

> This rule of law forces the filing of distinct applications in many situations resembling that before us and creates the complexities and delays which could be avoided under a less rigid statute.

However, in SAB Industri A.B. v. The Bendix Corp., 199 U.S.P.Q. 95 (E.D. Va. 1978), the Virginia District Court noted that neither the statute or any rule of the Patent and Trademark Office provides that joint inventors must have combined their efforts to each claim in the patent. In view of the problems noted by Judge Rich above, the uncertainty resulting from different judicial interpretations, a need for the first purpose of this amendment becomes quite evident.

The second purpose is to overcome the difficulty in what does, in fact, constitute joint inventorship. As stated by the judge in Mueller Brass Co. v. Reading Indus., 352 F. Supp. 1357 (E.D. Pa. 1972):

> The exact parameters of what constitutes joint inventorship are quite difficult to define. It is one of the muddiest concepts in the muddy metaphysics of the patent law.

Researchers in an organization sometime work on one aspect of an invention, while others may work on a different aspect. Personnel are continually added to the research team, while others may leave the team. Concepts and developments are often generated through brainstorming and cannot accurately be attributed to a particular inventor or inventors. The criteria for joint inventorship, as the amendments to Section 116 would state such criteria, have been judicially recognized. The District of Columbia district court noted in Monsanto Co. v. Kamp, 154 U.S.P.Q. 259 (D.D.C. 1967) that to constitute joint inventorship it is not necessary that (1) the co-inventors physically work together or at the same time, or (2) the co-inventors make the same type or amount of contribution to the invention. In addition to clarifying this "muddy" concept of the patent law, the suggested amendment also serves to insure that the patent specification provide a more complete disclosure relative to the requirements of enablement and best mode, by making it clear that persons who have made contributions can be included as inventors, even when a question exists as to whether their contribution is "an inventive contribution."

As we said above, the originally proposed wording of Section 6 achieves only the first objective and does not state specific criteria for joint inventorship. The original wording merely substitutes a new, undefined term, i.e., that each have made "an inventive contribution." The amendment to Section 116 we recommended follows along with a conforming amendment to Section 120 of Title 35:

> When an invention is made by two or more persons jointly, they shall apply for patent jointly and each make the required oath, except as otherwise provided in this title. Inventors may apply for a patent jointly even though (i) they did not physically work together or at the same time, (ii) each did not make the same type or amount of contribution to the invention, or (iii) each did not make a contribution to the subject matter of every claim to the invention.

Section 120 of Title 35 United States Code is amended to read:

> An application for patent for an invention disclosed in the manner provided by the first paragraph of Section 112 of this title in an application previously filed in the United States, or as provided by Section 363 of this title, by an inventor or inventors named in the previously filed application shall have the same effect, as to such invention, as though filed on the date of the prior application, if filed before the patenting or abandonment of or termination of proceedings on the first application or on an application similarly entitled to the benefit of the filing date of the first application and if it contains or is amended to contain a specific reference to the earlier filed application.

We have attached as an appendix a full discussion of the effect of the proposed amendments.

Sections 7, 8 and 9

The United States and Canada are the only industrialized countries in the world whose patent laws are based on the fundamental principle that only the "first" inventor is entitled to receive a patent. Other countries award patents to the first to file an application. The Commissioner of Patents regularly receives from different inventors applications for a patent on a substantially identical invention. The Commissioner is then responsible, pursuant to Section 135 of Title 35, to determine through interference proceedings which applicant was the first to invent. These proceedings are complicated and time consuming. Sections 8 and 9 will make needed improvements in this difficult area of patent practice which will benefit parties to a patent interference.

Section 7 provides that testimony in interference proceedings shall be provided by affidavit. The PTO is currently in the process of promulgating regulations which will substantially affect current regulations governing interferences. Until the new regulations are made final, and experience is gained as to their efficiency and effectiveness, this amendment should not be made. The new regulations provide no reason, however, to defer the amendments proposed in Sections 8 and 9 of the bill.

Section 8 would make two amendments to 35 U.S.C. 135(c). Under current 35 U.S.C. 135(c), interference settlement agreements must be filed before the termination of an interference, or, if good cause for delay is shown, within six months of the termination. Patents issuing from any involved application are rendered permanently unenforceable if the agreements are not filed in a timely fashion. The two changes set forth would, first, render such patents unenforceable only where the failure to file the agreement was not through error and without deceptive intent; and, second, would eliminate the statutory six month limitation on accepting late-filed agreements.

The rigidity with which existing 35 U.S.C. 135(c) operates is sufficient to justify the proposed change. The penalty under 35 U.S.C. 135(c) is too harsh; the failure to meet the six month limit for the filing of agreements is often in itself of no substantial harm to the public interest. If the failure to file was intentional for any reason, a patentee may fairly be said to have assumed the risk of unenforceability. If, however, for any reason the failure to make a timely filing was unintentional, there can be no question of a "deceptive intent" and the failure was clearly in error.

Elimination of the six month limitation on discretionary acceptance of belatedly filed agreements is appropriate. A patentee might have unintentionally failed to file an agreement and only after the six month grace period discover the need to do so. In such a case a part of the "good cause for failure to file" in a timely manner before termination would require a showing of diligence, i.e., a patentee would need to demonstrate that once the need to file was appreciated, he proceeded expeditiously with the filing. Any continuing failure to file would be intentional.

Section 9 would add a new section, 135(d), to permit the parties to an interference to determine priority or any other aspect of an interference by arbitration. Under this proposal, the parties would give notice of any arbitration award to the Commissioner which would then be dispositive of the issues to which it relates. The arbitration award would, however, be unenforceable until notice had been given to the Commissioner. With the recent enactment of 35 U.S.C. 294, (Public Law 97-247), arbitration agreements to settle issues of patent validity are made valid and enforceable. To authorize the use of arbitration here is wholly consistent with the public policy underlying 35 U.S.C. 294. Parties should be encouraged to seek more expeditious and economic alternatives to litigation in order to resolve disputes.

Historically, parties in interference have often agreed to settle the issue of priority of invention and other aspects of an interference proceeding amicably between themselves. In one sense, proposed 35 U.S.C. 135(d) merely permits parties who agree that an interference should be settled amicably to designate a third party to arbitrate the issue rather than to resolve it through arbitration-like activity by the respective counsel for the involved parties.

Should the proposed 35 U.S.C. 135(d) be enacted into law, then the PTO should be encouraged to exercise its rulemaking authority to facilitate arbitration of interferences. One rulemaking action which the PTO might take would be to suspend interferences for periods of up to six months upon notice by the parties to the PTO that they have agreed to conduct the priority determination by arbitration.

Section 10

The Supreme Court in Lear, Inc. v. Adkins, 395 U.S. 653 (1969) held that a person licensed to use a patent may challenge the validity of the patent in court. The Court expressly overruled the holding in Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc., 339 U.S. 827 (1950) that licensee estoppel was the "general rule."

The Court in Lear said the following:

> The uncertain status of licensee estoppel in the case law is a product of judicial efforts to accommodate the competing demands of the common law of contracts and the federal law of patents. On the one hand, the law of contracts forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made. On the other hand, federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent. . . When faced with this basic conflict in policy, both this Court and courts throughout the land have naturally sought to develop an intermediate position which somehow would remain responsive to the radically different concerns of the two different worlds of contract and patent. The result has been a failure. Rather than creative compromise, there has been a chaos of conflicting case law, proceeding on inconsistent premises.

Section 10 of the bill will bring the equities of these conflicts between patent licensors and licensees back into balance. The section codifies the result in Lear. However, it also provides that the licensee shall pay to the licensor the royalties agreed upon in the licensing contract until the contract is terminated. It also provides that either the licensor or the licensee can terminate the contract if the licensee challenges the validity of the patent in court.

Under the Lear doctrine, the contract rights of the licensor are largely illusory. A licensee is free to negotiate a contract to pay royalties to a patent owner and then at any time renege on the contract by either failing to pay the royalties or by bringing a declatory judgment action on the ground that the patent is invalid. The licensor must then either bring a breach of contract action against the licensor or defend the patent in the declaratory judgment action. Courts have adopted various theories on whether the licensee is required to continue to pay royalties during the course of litigation. In any case, currently the licensee risks virtually nothing. If the patent is valid, courts are very likely to find that the agreed upon royalties are the best measure of the worth of the patent. Therefore, after prevailing in the lawsuit the licensor will receive the royalties owed under the contract. Also, because the licensor remains bound to the contract, the licensee can continue to practice the invention after the patent is found valid.

The unfairness of the current state of the law is especially relevant when the licensor is an indivdiual inventor and the licensee is a large corporation. This is often the case and was in Lear. If a patent owner does not have the resources to utilize his invention, he must license it to another who possesses those resources. That licensee is able to bear the cost of litigation where the licensor is often hardpressed to do so.

The fact that the licensee has so little to lose, encourages a disregard for contract obligations and encourages litigation. Neither result is desirable.

Section 11

The effective date in this section is justified as to the amendments made in Sections 2, 3, 4, 8, 9, and 10. However, we recommend that amendments be made to the bill regarding the effective dates of Section 1 and Sections 5 and 6.

As to Section 1 we recommend the following:

> (b) The amendments made in Section 1 shall apply to any U. S. patent granted after the date of this Act; and shall apply to any unexpired U. S. patent granted prior to the date of this Act, provided that no liability shall attach to the importation, sale or use of a product imported into the U. S. before the date of this Act, where such liability is founded solely on subsection (e) and to the supply of any components before the date of this Act, where such liability is founded solely on subsection (f).

Section 1 will enhance the ability of American patent owners to compete in international and U. S. markets, and to prevent the evasion of the rights of U. S. patent owners. Therefore, the strengthening of such rights should apply to unexpired U. S. patents, many of which still have a significant period to run. However, it would be unfair to attach infringement liability to a party as a result of acts which were permissable prior to the effectuation of this Act. Therefore, the proposal for the effectiveness as to Section 1 removes such liability as to any product imported into the U. S. [subsection (e)] and as to components supplied [subsection (f)] prior to the date of the Act.

As to Sections 5 and 6 we recommend the following:

> (c) The amendments made in Sections 5 and 6 shall apply to any U. S. patent granted after the date of this Act; and shall apply to any unexpired U. S. patent granted prior to the date of this Act, provided that no liability shall attach to any action taken before the date of this Act in reasonable reliance on a written opinion that such prior granted patent should be held invalid as a result of consequences which this Act now obviates.

Sections 5 and 6 will obviate certain undesirable interpretations which have resulted from the wording of sections 102(f) and (g) of Title 35. Because it is designed to correct existing inequities, it should apply to patents issued prior to the passage of the legislation. However, there may exist some instances in which parties may have relied on the advice of counsel as to the invalidity of a patent, which advice was founded on factual situations resulting from joint inventorship. Such instances will be very small in number, since a knowledge of those factual situations would, generally, only become known during the course of discovery during litigation.

S. 1841

This bill, proposed in September of 1983 by President Reagan and entitled the "National Productivity and Innovation Act of 1983," amends the antitrust, patent, and copyright laws "in ways that will enhance this country's productivity and the competitiveness of U. S. industries in international markets."

Title II of S. 1841 is intended to stimulate research and development joint venturers for the purpose of maximizing the creation of new technology. Titles III and IV of the bill are intended to encourage and promote the efficient use of this newly created technology. Very often, the creators and owners of advances in technology in the form of intellectual property are not able to fully develop its commercial applications. In those cases, the most effective, and often the only, method of bringing this technology to the marketplace is for its owner to license it to another with the ability to do so. However, despite the practical benefits of licensing to the industrial innovation process, courts have sometimes found intellectual property licensing practices to be unlawful without fully considering the effect of the practices on competition.

The AIPLA supports the enactment of Titles III and IV of S. 1841 which will ameliorate the legal uncertainty now surrounding the licensing of intellectual property. Due to time constraints, we were unable to include in this statement the reasons why we believe these proposals should be enacted. Also, we would like to recommend a technical amendment to Title IV for the Subcommittee's consideration. With the Chairman's permission, we will file a supplemental statement promptly, which outlines in full the AIPLA position.

Thank you. This completes our statement. We would be pleased to answer any questions the Subcommittee may have.

APPENDIX

Analysis of Proposed Amendment to Section 5 of S. 1535

Section 5 of this bill amends section 103 of title 35, United States Code, by adding to the end of section 103 a new sentence providing that subject matter developed by another which qualifies as prior art only under sections 102(f) or (g) of title 35 shall not negative patentability when the subject matter and the claimed invention were commonly owned at the time the invention was made.

The term "subject matter" as used in this amendment is intented to be construed broadly in the same manner as the term is construed in the remainder of section 103. The term "another" as used in this amendment means any inventive entity other than the inventor and would include the inventor and any other person. Thus, subject matter developed jointly by the inventor and any other person would be "subject" matter developed by another" for purposes of this amendment and insofar as the claimed invention is concerned. The term "developed" is to be read broadly and is not limited to the manner in which the development occurred.

The subject matter which is disqualified as prior art under section 103 is strictly limited to subject matter which qualifies as prior art only under sections 102(f) or (g). If the subject matter qualifies as prior art under any other section, e.g., section 102(a), (b) or (e), it would not be disqualified as prior art under the amendment to section 103. The amendment only applies to subject matter which qualifies as prior art under section 103. It does not apply to or affect subject matter which qualifies as prior art under section 102.

The amendment is not intended to permit anyone other than the inventor to be named as the inventor in a patent application or patent. Also, the amendment is not intended to, and does not, ratify or enable appropriation of the invention of another. For example, if the subject matter developed by another is the same as that claimed, and would thus anticipate the claimed invention under section 102, the amendment would not disqualify the subject matter as prior art. Section 5 of this bill also makes clear that subject matter derived from another under section 102(f) is prior art under section 103 unless the derived subject matter and the claimed invention are commonly owned. The contents of a secret co-pending patent application, of the same or different ownership, continue to be available as prior art under section 103 by virtue of section 102(e) as of the application filing date. If subject matter becomes potential prior art under section 102(e) because a patent application is filed on such subject matter before a commonly owned claimed invention is made the subject matter of a later application, the two applications may be combined into a single application under the changes contained in section 6 of this bill and such subject matter would no longer constitute potential prior art under section 102(e) or under Section 103.

In order to be disqualified as prior art under the amendment the subject matter which would otherwise be prior art to the claimed invention and the claimed invention must be commonly owned at the time the claimed invention was made. The term "commonly owned" is intended to mean that the subject matter which would otherwise be prior art to the claimed invention and the claimed invention are entirely or wholly owned by the same person, persons, or organization at the time the claimed invention was made. If the person, persons, or organization owned less than 100 percent of the subject matter which would otherwise be prior art to the claimed invention, or less than 100 percent of the claimed invention, then common ownership would not exist. Common ownership requires that the person, persons, or organization own 100 percent of the subject matter and 100 percent of the claimed invention. As long as principal ownership rights to either the subject matter or the claimed invention reside in different persons or organizations common ownership does not exist. A license of the claimed invention to another by the owner where basic ownership rights are retained would not defeat ownership. The requirement for common ownership at the time the claimed invention was made is intended to preclude obtaining ownership of subject matter after the claimed invention was made in order to disqualify that subject matter as prior art against the claimed invention. The question of whether common ownership exists at the time the claimed invention was made is to be determined on the facts of the particular case in question. Actual ownership of the subject matter and the claimed invention by the same individual or organization or a legal obligation to assign both the subject matter and the claimed invention to the same individual or organization must be in existence at the time the claimed invention was made in order for the subject matter to be disqualified as prior art. A moral or unenforceable obligation would not evidence common ownership.

Under this amendment of section 103, an applicant's admission that subject matter was developed prior to applicant's invention would not make the subject matter prior art to applicant if the subject matter qualifies as prior art only under sections 102(f) or (g) of title 35 and if the subject matter and the claimed invention were commonly owned at the time the invention was made. See In re Fout, 213 USPQ 532 (CCPA 1982), for a decision involving an applicants' admission which was used as prior art against their application. If the subject matter and invention were not commonly owned, an admission that the subject matter is prior art would be usable under section 103.

The burden of establishing that subject matter is disqualified as prior art under the section is intended to be placed and reside upon the person or persons urging that the subject matter is disqualified. For example, a patent applicant urging that subject matter is disqualified as prior art under the amendment would have the burden of establishing that it was commonly owned at the time the claimed invention was made. The patentee in litigation would likewise properly bear the same burden placed upon the applicant before the Patent and Trademark Office. To place the burden upon the patent examiner or the defendant in litigation would not be appropriate since evidence as to common ownership at the time the claimed invention was made might not be available to the patent examiner or the defendant in litigation, but such evidence, if it exists, should be readily available to the patent applicant or the patentee.

In view of this amendment it would be expected and intended that the Commissioner would reinstitute in appropriate circumstances the practice of rejecting claims in commonly owned applications of different inventive entities on the grounds of double patenting. Such rejections could then be overcome in appropriate circumstances by the filing of terminal disclaimers. This practice has been judicially authorized. See In re Bowers, 149 USPQ 571 (CCPA 1966). The use of double patenting rejections which then could be overcome by terminal disclaimers would preclude patent protection from being improperly extended while still permitting inventors and their assignees to obtain the legitimate benefits from their contributions.

Analysis of Proposed Amendments to Section 6 of S. 1535

Section 6 of this bill amends section 116 of title 35 by adding to the end of section 116 a new sentence recognizing that inventors may apply for a patent jointly even though (i) they did not physically work together or at the same time, (ii) each did not make the same type or amount of contribution or (iii) each did not make a contribution to the subject matter of every claim of the patent. Determinations of inventorship in patent law are recognized as different undertakings and the amendment seeks to clarify and, to the extent possible, to simplify such undertakings by adopting and introducing into section 116 some principles set forth in judicial precedents. The court in Monsanto Co. v. Kamp, 154 USPQ 259 (D.D.C. 1967) stated the pertinent principles as follows:

> "A joint invention is the product of collaboration of the inventive endeavors of two or more persons working toward the same end and producing an invention by their aggregate efforts. To constitute a joint invention, it is necessary that each of the inventors work on the same subject matter and make some contribution to the inventive thought and to the final result. Each needs to perform but a part of the task if an invention emerges from all of the steps taken together. It is not necessary that the entire inventive concept should occur to each of the joint inventors, or that the two should physically work on the project together. One may take a step at one time, the other an approach at different times. One may do more of the experimental work while the other makes suggestions from time to time. The fact that each of the inventors plays a different role and that the contribution of one may not be as great as that of another does not detract from the fact that the invention is joint, if each makes some original contribution, though partial, to the final solution of the problem."

The amendments to section 116, in (i) and (ii), adopt as statutory criteria the pertinent principles of Monsanto Co. v. Kamp.

The amendment to section 116 also provides that inventors may apply for a patent jointly even though each did not make a contribution to the subject matter of every claim of the patent.

This amendment recognizes the realities of corporate and team research. A research project in today's environment may include many inventions and some inventions may have contributions which are made by some individuals who were not involved in other aspects of the invention. It is appropriate to recognize the contribution of each individual even though the individual may not have been involved in, or may not have contributed to, all aspects of the invention. The amendment to section 116 would permit this recognition by not requiring that each inventor make a contribution to every claim of the patent. Under the amendment to section 116, an inventor could apply for a patent jointly with other inventors as long as each inventor made a contribution, i.e., was an inventor or joint inventor, of the subject matter of at least one claim of the patent. While the principle that each inventor does not have to make a contribution to every claim of the patent was recognized by the court in SAB Industri v. Bendix Corp., 199 USPQ 95 (E.D. Va. 1978), it is appropriate that this principle be incorporated into section 116 in order to clarify the criteria for joint inventorship. It is not intended that this amendment encourage the inclusion in one application of more than one invention. However, to the extent that more than one invention is included in an application, the Commissioner may require the application to be restricted to one of the inventions in accordance with the provisions of section 121 of title 35. In such case, any divisional applications filed would be entitled to the filing date of the original application, even if the inventorship changes in the divisional application, as long as the subject matter of the original application and the divisional application are commonly owned.

The amendments to section 116 increase the possibility that the claims of a particular application may have different dates of invention to which they are entitled. For example, one inventor may have developed part of the invention represented by some claims. On a later date another inventor may have developed another part of the invention which is claimed in other claims. The two inventors could have jointly developed the subject matter of other claims at an even later time. Under the amendment to section 116, a single application could be filed on behalf of the two inventors. At the same time, there is no requirement that all the inventors be joint inventors of the subject matter of any one claim. Where necessary for purposes of examination of the patent application or during the course of patent litigation involving the patent, the Patent and Trademark Office or the court before which the litigation is pending may inquire of the patent applicant or the patentee as to the inventorship and the invention dates of the subject matter of the various claims.

The amendments to section 116 also delete the reference to "sign the application" to be consistent with earlier changes to section 111 and to clarify that it is not necessary for each inventor to separately sign the application, in addition to making the required oath and applying for a patent jointly.

Section 6 of this bill amends section 120 of title 35, United States Code, to provide that a later filed application by an inventor or inventors of a previously filed pending application may claim the benefit of the previously filed pending application even though the later filed application does not name all of the same inventors as the previously filed application. For example, if the previously filed application named inventors A and B as the inventors, a later application by either A or B could be filed during the pendency of the previously filed application and claim benefit of the previously filed application under section 120 of title 35. In order for the claims of the later filed application to be entitled to the benefit of the date of the earlier filed application, the requirements of section 120 would have to be met, including the requirement that the subject matter of the claims of the later filed application be disclosed in the earlier filed pending application in the manner provided by the first paragraph of section 112 of title 35.

Similarly, if inventor A filed an application on an invention and during the pendency of that application made an improvement on the subject matter of the application as a joint inventor with inventor B, the joint application filed on behalf of inventors A and B could claim the benefit of A's previously filed sole application to the extent that the later filed joint application contained claims to A's subject matter which was disclosed in the earlier filed pending application in the manner provided by the first paragraph of section 112 of title 35.

Likewise, an application filed by inventors A and C could claim the benefit of an earlier filed pending application of inventors A and B, to the extent that the requirements of section 120 could be met.

The Patent and Trademark Office or a court before whom the patent is being litigated may inquire, in appropriate circumstances, as to who invented, and the date of invention of, the subject matter being claimed in any claims in the later filed application. In order to be entitled to the benefit of an earlier filed pending application, the subject matter of the claims of the later filed application would have to be disclosed in the manner provided by the first paragraph of section 112 of title 35.

The prohibitions of double patenting would also be applicable to the applications or patents, whether or not they are commonly owned. If the applications or patents are commonly owned, the rejection of the application on the grounds of double patenting could be overcome by an appropriate terminal disclaimer as long as the identical invention is not being claimed. See *In re Robeson*, 141 USPQ 485 (CCPA 1964), and *In re Kaye*, 141 USPQ 829 (CCPA 1964). If the applications or patents are not commonly owned, the double patenting rejection of the later filed application could not be overcome by a terminal disclaimer since the ownership of subject matter being claimed belongs to someone other than the owner of the later filed application.

SUPPLEMENTAL STATEMENT OF BERNARR R. PRAVEL

As this Committee is aware, the American Intellectual Property Law Association (AIPLA) is a national society of more than 4800 lawyers engaged in the practice of patent, trademark, copyright, licensing, and related fields of law affecting intellectual property rights. AIPLA membership includes lawyers in private, corporate, and government practice; lawyers associated with universities, small business, and large business; and lawyers active in both the domestic and international transfer of technology.

We submit this report in amplification of our support of Titles III and IV of S. 1841. AIPLA believes these initiatives by the Congress will materially assist American creators of intellectual property as will the legislation we discussed before the Committee on April 3, 1984.

I. INTRODUCTION

The AIPLA supports Title III of S. 1841 with one exception and supports Title IV of S. 1841 in principle although it is not certain that the specific prohibitions are needed if Title III is enacted.

As to Title III, the AIPLA believes it is in the public interest, for it provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, know-how, or other intellectual property shall not be deemed illegal *per se* in actions under the antitrust laws, and it limits damages to actual damages in actions based on such agreements which are brought under Section 4 or Section 4C of the Clayton Act. While the AIPLA believes that Title III should exclude agreements to convey rights to use trademarks from the coverage of the Title, the unifying principle of Title III will make it clear to courts that the rule of reason is to govern the evaluation of licensing practices involving intellectual property.

As to Title IV, while the AIPLA endorses it in principle, it is not certain that the specific practices set forth therein need to be enumerated in order to free up licensing practices from the cloud of the unreasonable threat of the antitrust laws.

The AIPLA supports the passage of Title IV of the Act which provides that conduct cannot be found to constitute patent or copyright misuse unless such conduct actually violates the antitrust laws. Title IV should probably be amended, however, to make it clear that the party asserting a misuse does not have to satisfy antitrust standing or antitrust injury requirements of the antitrust laws to be able to raise the defense of misuse.

II. DISCUSSION: INTELLECTUAL PROPERTY LICENSING ARRANGEMENTS

Title III of S. 1841 would do two things. First, it would add a new Section 27 to the Clayton Act which provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal *per se* in actions under the antitrust laws. Second, it would limit damages in antitrust cases involving such agreements to actual damages plus prejudgment interest.

The AIPLA supports the passage of Title III of the Act, not only because it places single-firm licensing activities on an equal footing with joint research and development programs with respect to the appropriate antitrust standard to be applied and the damages allowable where challenged practices are found to be anticompetitive (which is covered by Title II of S. 1841), but because it will encourage innovation by improving the licensing climate for intellectual property. As the Department of Justice has noted in its Detailed Analysis of Antitrust Legislative Reforms Proposed by the Department of Justice (March 1983), the antitrust risks incident to licensing arrangements which are perceived can both deter research and development activities and limit access to proprietary innovations developed by other parties. These, in turn, reduce the potential for the widest commercialization of innovations, not to mention their creation in the first instance.

The legality of intellectual property licensing arrangements must be judged under rule of reason, as Title III demands, if we are to promote commercially attractive licensing arrangements. Limiting antitrust damages which involve such arrangements to actual damages as Title III also provides will have the additional advantage of minimizing the overkill potential of the antitrust laws where they are properly brought into play.

While some, for example, Professor Kaplow of Harvard Law School, oppose the adoption of the rule of reason in all cases because economic analysis is complex and difficult, the AIPLA believes it is essential to weigh the competitive effects of challenged practices. The Supreme Court has come to this conclusion as it so eloquently stated in Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). The AIPLA does not believe Title III will prevent proven anticompetitive practices from being condemned. It will, however, require courts to evaluate all the evidence on the probable economic effects of the challenged practice rather than apply a per se rule which may be easy to use, but is not necessarily just or even economically defensible. While it has been suggested that detrebling antitrust damages in situations where the practice is based on a licensing arrangement involving intellectual property goes too far, we believe actual damages plus reasonable attorney fees is more than enough to encourage victims of unlawful conduct to seek redress in the courts. Moreover, since the exclusions of Title III only apply where the disputed conduct is based on an intellectual property licensing agreement, if such an agreement is used as a shield for a naked restraint of trade, for example, it should not prevent the application of conventional antitrust principles.

III. DISCUSSION: TITLE IV PATENT AND COPYRIGHT MISUSE

Title IV of the Act would amend 35 U.S.C. § 271 to provide that enumerated patent and copyright licensing practices cannot provide the basis for a finding of misuse or illegal extension of the patent unless such practices, in the circumstances in which they are employed, violate the antitrust laws. Although the courts have held that some of the enumerated licensing practices were a misuse, the list includes practices which have never been so categorized.

While the AIPLA believes licensing practices of patent and copyright owners should not prevent enforcement of the property rights unless the practice in light of all the circumstances violates the antitrust laws, we do not believe it is necessary, or even desirable, to set out specific practices unless it is made clear that they are by way of example, rather than by way of limitation. Such a clarification would make the statutory language consistent with the Justice Department's statement concerning this Section. On balance, the AIPLA believes the desirable results of Section 401(d) pertaining to patents and Section

402 pertaining to copyrights can be attained by changing these two sections to read as follows:

> Sec. 401. Section 271 of title 35, United States Code, is amended --
>
> (d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his licensing practices or actions relating to his patent, unless such conduct, in view of the circumstances in which it is employed, violates the antitrust laws.
>
> Sec. 402. Subsection (a) of section 501 of title 17, United States Code, is amended by adding at the end thereof the following: "No copyright owner otherwise entitled to relief for infringement of a copyright under this title shall be denied relief or be deemed guilty of misuse or illegal extension of the copyright by reason of his licensing practices or actions relating to his copyright, unless such conduct, in view of the circumstances in which it is employed, violates the antitrust laws."

These proposed modifications of the misuse doctrine are necessary elements of the Act's overall purpose of encouraging intellectual property licensing. There is no reason why intellectual property owners should not be able to enforce their statutory rights in situations where their licensing activities do not violate the antitrust laws. It would be inconsistent to limit damages for antitrust violations in the context of licensing arrangements and leave a misuse doctrine in place which confronts intellectual property holders with the prospect of being unable to enforce their patents or copyrights because of economic provisions in licensing agreements which, while they may be somewhat anticompetitive, do not even constitute antitrust violations.

It should be noted that Title IV, with or without our proposed amendments, would not alter existing law with respect to the misuse doctrine as it applies to improper practices not related to competition (e.g., fraud on the

Patent and Trademark Office and the like). Rather, it would merely require and ensure that economic analysis has been conducted before a court would be able, properly, to refuse to enforce a valid patent or copyright because of anticompetitive practices.

Although the misuse doctrine is grounded in national economic policy as expressed in the antitrust laws, as this Committee is aware, the courts have stated that various forms of allegedly "anticompetitive" conduct may constitute patent misuse even though the conduct does not violate the antitrust laws. Where licensing activities contravene national competition policy, as expressed in the antitrust laws, a finding of misuse and unenforceability makes sense. However, conduct should not be condemned as patent misuse on economic grounds unless the conduct actually violates the antitrust laws. Title IV codifies these principles, and the AIPLA supports the proposed Title, in principle.

AIPLA also strongly urges a change in the designation of the new paragraph added to Section 271 of title 35, United States Code, as paragraph "(e)" instead of "(d)", and also leaving present subsections (c) and (d) of Section 271 as now in title 35.

It is our concern that some meaning may be read into the re-designation of present subsection 271(d) to subsection 271(c)(2) as proposed in Section 401 of S. 1841. The present subsection 271(d) is not limited to contributory infringement, whereas present subsection 271(c) is so limited. By the re-designation of those two subsections, i.e. putting both together, it may create a misconception that the statutory intent was to limit present subsection 271(d) to contributory infringement. Although paragraph (d) does speak in terms of "contributory" infringement in defining these three exceptions, the legislative history of Section 271 and writings by those who drafted the provision clearly indicate that "contributory" infringement as used in paragraph (d) refers both to inducement of infringement under paragraph (b) and the special type of contributory infringement defined in paragraph (c). To cite several examples of this:

1. The revision notes to Section 271 state that "Paragraphs (b) and (c) define and limit contributory infringement of a patent and paragraph (d) is ancillary to these paragraphs ...."

2. In Frederico's Commentary on the New Patent Act, he states "There is apparently some looseness in the use of the terms 'infringement' and 'contributory infringement' which ought to be considered immaterial in construing the Section."

3. Giles Rich, the primary drafter of Section 271, has made it very clear that paragraph (d) applies to both paragraph (b) and (c). In an article by Mr. Rich, entitled Infringement Under Section 271 of the Patent Act of 1952, [illegible] J.P.O.S. 476 (1953), Mr. Rich stated:

> Paragraphs (b) and (c) deal with two kinds of contributory infringement.... Both of them define and limit contributory infringement and paragraph (d) is ancillary to these paragraphs.
>
> As to paragraph (d), its purpose is to make the appropriate exceptions to the misuse doctrine as it has seemed to exist since the Mercoid case, at least in the Supreme Court and the jurisdictions which accept what it has said as law, and its effect, in the simple words of the Judiciary Committee Report, is this: one who merely does what he is authorized to do by statute is not guilty of misuse of the patent. The reference to statutory authority is, of course, to the full legal implications of paragraphs (b) and (c).
>
> Clause 1 of paragraph (d) states: "derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent." Now visualize any situation in which an unauthorized person would be held liable under paragraphs (b) or (c) and then

> suppose if the patentee is doing the same thing and profiting from it.... If, under Section 271, a patentee could hold someone else liable for doing what he himself is doing businesswise, his business conduct is no misuse. Whether the conduct falls within Section 271(b) or (c) would seem to be immaterial. Paragraph (d) applies.

To avoid a potential mistaken reading of the statute, AIPLA strongly urges the above change in Section 401.

IV. CONCLUSION

The AIPLA supports Title III and IV of S. 1841 and urges the Committee to report such legislation favorable. This completes our Statement. We thank the Committee for the opportunity to present this Supplemental Statement.

Senator **Mathias**. Let me ask Mr. Banner first the same question that I asked the Commissioner, and that is if we run into controversy over this bill and are not able to enact all the features that you have recommended, where do you think the greatest urgency lies, where are your priorities?

Mr. **Banner**. I would agree with the Commissioner, Senator, that the first matter of importance would be the section concerning the foreign activity and U.S. process patents. I think that is No. 1.

The second thing, I agree with the commissioner, is with respect to the foreign filing licenses. I think that is very important. However, I would disagree with the Commissioner in the other areas.

The third point I would think important would be the Bass situation, the secret prior art situation. And the fourth point would be the Lear aspect. I would list them in that order.

Senator **Mathias**. Let me ask Mr. Dorfman for his statement before I ask further questions.

STATEMENT OF JOHN C. DORFMAN

Mr. **Dorfman**. Thank you, Mr. Chairman.

As you know, I am the current chairman of the section of patent, trademark and copyright law of the American Bar Association. With me here this morning is Mr. George Whitney of New York, who is chairman of our Antitrust Committee. Mr. Whitney is here particularly in view of the S. 1841 provisions.

Our section, as you may know, has a peculiar way of operating relative to others who are testifying here today. Before we adopt resolutions, we must have a meeting of our full section. Our section represents about 6,000 lawyers plus, and we would have a meeting of, let us say, 500 of those people who completely debate a particular resolution which has previously been considered very exhaustively by committee.

So perhaps our work is more extensive, even though we are not able to comment on everything here today. We do support today sections 1, 2, 3, and 4, and I should mention in connection with section 1 that this is the importation of a product made by a patented process.

You have asked some questions about that. That is a matter that dates back to the President's Commission report of 1966, and it has been an agenda item since the ABA bill in 1967, the Dirksen bill. There has been historical support for this right along. So it has been something that has been what I would call a very high priority item.

In connection with this particular section, however, we like the provision that is in 1841, that is, we would modify the text to provide that the product must be made during the term of the patent to be an infringement.

I think the reason for that is apparent. We do not want to have situations where you have a perpetual right growing out of a product that has been made at some other time. So this is a reasonable limitation. It appears in 1841, and we support section 1, paragraph (a), to that extent.

I have misstated our position relative to the second paragraph, that is, paragraph (f), the amendment to section 271. Actually our section has a resolution. The reason why I took the position that we had no position was that we do not have the so-called blanket authority, that means it has not been submitted to other sections for review. We are doing that, and we will try to get it back to you within the 3 weeks if possible or at least as soon as we can thereafter.

But I am sure that we will support that concept of infringement by a product that the parts are made in the United States for assembly abroad. We do clearly support the matters that relate to the license, and we think that the rules, as they presently stand, due to judge-made law, are extraordinarily harsh.

Section 3 is particularly important, I think, because the language "through error and without deceptive intent" has been interpreted such that an attorney error can cause his client, cause the patentee to lose a patent that is worth millions of dollars, and it can be a perfectly good-faith situation.

Changing that language to one that involves inadvertence would avoid that kind of problem. The case that is the leading case in this field that illustrates the problem is the *In re Gaertner* case which is cited in my testimony.

Section 2 makes it unnecessary to obtain additional licenses for what I might exaggerate by calling trivial matters, that is, when there are minor additions or amendments, changes, they can go in.

We also support section 4 which is the penalty, the criminal penalty elimination. I should say that relative to S. 1841, we support the section of antitrust. This is an unusual situation for the patent section and the antitrust section to be so unanimous.

To summarize the thing, we have an ABA position which, effectively, specifies licenses should be not subject to severe restraints. They should be treated on the basis of the rule of reason instead of on the current basis which is rather harsh. That really is a summary of the thing.

The section 3 of that bill, S. 1841, would put the individual patentee on the same basis as the joint venture people if sections 1 and 2 are passed, and, of course, we think they should be passed, too, even though that is not before the committee.

Maybe Mr. Whitney can add something to this.

STATEMENT OF GEORGE WHITNEY

Mr. **Whitney**. Very quickly, I think that in reference to any considerations on titles III and IV, that we should not forget the extensive past history. I brought these with me today merely as illustrative of the hearings that were before this committee in 1968, the hearings that were before this committee in 1971, relative to the so-called Scott amendments, relative to the house of delegates formal ABA position, not just this section's position in 1967 endorsing the rule of reason, and also recognizing that this question of the per se handling of patent matters in antitrust interface is something that goes back substantially before that. It has a genesis in part subsequent to the 1952 act and the 1955 Attorney General's report on the antitrust system which endorsed the rule of reason at that time.

The courts started wandering quite afield from the application and recommendations there, and that was one of the things that brought the ABA in to setting up a special committee prior to the institution of the Presidential Commission in 1965.

So this has a long history. We have set it out in a paper that has been submitted of some 15 pages that I think should be borne in mind when considering these things, and as has been said recently, it is not exactly what may be the conditions of specific law, it is a matter of perception.

And, your concerns and the concerns of the other Members of Congress relative to promoting innovation in this country and the posture of the United States must be concerned with the question of perception, because it directly influences these things.

There is an opportunity to do something that has been long in the wind and long needed, and I recommend it strongly and urge that this Congress attempt to address and work on this subject of titles III and IV.

It is not something that is new or to be put aside. It is something that needs to be done. Thank you.

[Submissions of Mr. Dorfman follow:]

PREPARED STATEMENT OF JOHN C. DORFMAN

Our Section is appreciative of the invitation and the opporutnity for me to testify in my capacity as Chairman of the American Bar Association Section of Patent, Trademark and Copyright Law, in support of the provision of S. 1535. I will testify in support of the provision of S. 1535 making importation of a product made outside of the United States by the patented process infringement of the United States patent. In addition, we support aspects of S. 1535 which alleviate some of the unnecessarily harsh effects of the requirement of failing to obtain a license before filing a patent application abroad. These views are being presented only on behalf of the Section of Patent, Trademark and Copyright Law and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and should not be construed as representing the position of the ABA.

Because of the procedures of our Section requiring passage of resolutions at the general meeting held once each year, but allowing participation of the entire Section membership, our response tends to move deliberate. Further issues raised by this legislation have not yet been considered by the Section and cannot be considered until the meeting in August. Under the circumstances you should not interpret our silence on a particular matter as anything more than having taken no position.

Today I also testify on behalf of the Patent, Trademark and Copyright Law Section broadly supporting the position of the Section of Antitrust Law relative to S.1841 to the extent you are considering that bill. However, with regard to broad aspects of Titles III and IV of that bill, there is full American Bar Association authority. The American Bar Association in 1967 adopted certain resolutions which are still in effect and which pertain to Titles III and IV of S. 1841. These have to do with clarification of the law relating to licensing of patents dating back to a recommendation of the President's Commission on Patent Policy Planning formed in 1965.

Importation of a Product Made Outside the United States by a Patented Process

The Patent, Trademark and Copyright Section at the 1983 annual American Bar Association meeting in Atlanta adopted the following resolution:

> Resolved, that the Section of Patent, Trademark and Copyright Law favors in principle the enactment of legislation to provide that whoever without authority from the patentee imports into the United States or uses or sells in the United States a product made in another

> country by a process patented in the United States and made during the term of that patent shall be liable as an infringer.

This resolution is in direct support of the provision of S. 1535 Mathias pertaining to the scope of protection afforded to United States process patents. It also would support in principle Title V of S. 1841. Specifically, it is an endorsement of S. 1535, the first paragraph of Section 1, which would amend S271 of Title 35 of the United States Code to include in it the following new provision:

> (e) Whoever without authority imports into or uses within the United States a product made in another country by a process patented in the United States shall be liable as an infringer.

You will note that our resolution proposes a modification to the language of S. 1535 in that it recommends that the product must be made during the term of the patent to be an infringement. This recommendation was adopted by the bill H.R. 4526 introduced in the House of Representatives and we solicit your consideration of it in respect to S. 1535 since it adds certainty as to the time frame of the patent protection.

We strongly feel that legislation is needed to provide the owners of process patents with adequate remedies so that foreign manufacturers cannot use the patented processes to make products without liability for sale in the United States.

Many of today's significant inventions involve new processes used to make existing--and, therefore, unpatentable--products. These new processes may be extremely valuable, as, for example, can be seen from the litigation, United States v. Studiengesellschaft Kohle, Gmbh, 670 F2d 1122 (D.C. Cir. 1981), arising out of a new process for making aluminum tri-alkyls. The relevant process, known as the Ziegler process, revolutionized the tri-alkyl industry even though the end product was the same as before.

A manufacturer in the United States seeking to use a new patented process, such as the Ziegler process, must, of course, reach an accommodation with the patent owner by licensing or otherwise. But a foreign manufacturer using the new process to make products for sale in the United States has no liability under the United States process patent. The foreign manufacturer can produce abroad with no liability, and import and sell here without liability; the United States patent simply does not reach those activities.

This unfortunate circumstance occurs because process patent protection under current United States law does not extend to the product of the patented process. As a result, an unpatented product made offshore by a patented process can be sold here without constituting an infringement. In contrast, the domestic patent law of other major countries would prevent similar importation into those countries by a United States manufacturer. For example, the European Patent Convention states: "If the subject matter of the European patent is a process, the protection conferred by the patent shall extend to the products directly obtained by such process." Convention on the Grant of European Patents, Art. 64(2). If the product produced by the patented process is itself novel, the defendant is burdened in many of these countries with proving that his product was not produced by that process.

In certain circumstances the importation of products produced offshore by a U.S. patented process may be actionable in this country before the U.S. International Trade Commission as an unfair method of competition. The ITC proceedings under 19 U.S.C. 1337(a) provide for an exclusion order to be issued against the products made abroad by a process covered by a United States process patent, but these proceedings are not a completely satisfactory remedy for the process patentee for a number of reasons.

First of all, the patentee must prove that there is an efficient and economically operated industry in the United States operating under the patent. This is difficult at best, particularly for individual and small business patentees, and also, it may require the disclosure of financial information which the United States patent owner wishes to preserve on a confidential basis. The latter reason is one why some companies refuse, or are reluctant, to use the ITC proceedings.

A second reason why the ITC proceedings are unsatisfactory is that they do not provide for the recovery of damages suffered by the patentee. The foreign user of the patented process can send significant amounts of goods into the country before being subjected to an exclusion order. It can thus take a large part or, conceivably even all, of the market for an extended period without ever having to respond in damages.

The ITC proceedings are further nonsatisfactory to some companies because of the active participation in them by the staff of ITC. Instead of the patentee being able to handle the case in the way it chooses in its own best interests, it may find the time schedules, proofs and even settlement discussions subject to monitoring and perhaps intereference from the ITC staff.

Still another undesirable aspect of the ITC proceedings is they result only in an exclusion order subject to Presidential disapproval. The President, if he is unwilling to allow the exclusion order perhaps for some policy or political reason, may disapprove the order and the patentee gets no relief.

Given these problems with the ITC proceedings and the lack of any sanctions under the patent law, it is the position of the Patent, Trademark and Copyright

Section that remedial legislation is eminently in order. In fact, it is believed that legislation is particularly appropriate at this time of ever increasing worldwide competition so as to close the loophole which allows foreign manufacturers to avoid the effects of the United States process patents to which their American competition are subject.

The need for appropriate legislation to amend the Patent Code is recognized and supported by the present Administration. The Honorable Gerald J. Mossinghoff, Commissioner of Patents and Trademarks, in a speech before the Patent, Trademark and Copyright Section at the ABA Annual Meeting on August 7, 1982, expressed the support of the Patent and Trademark Office for an amendment of 35 U.S.C. 271 to close the gap in United States process patent protection. In addition to S. 1535 and S. 1841 there are now at least two other bills pending in Congress that would amend the scope of process patent protection according to a specific proposal of Administration. These bills are H.R. 3577 - Moorhead, and H.R. 3878 - Moorhead. They would all extend the scope of process patents to cover products made by the patented process whether produced abroad or in the United States.

H.R. 3577 is directed solely to process patent coverage, while H.R. 3878 and S. 1841 include it together with other subjects believed by the Administration to be important for simulating innovation and productivity in the United States. In the analysis accompanying the latter two bills it is noted that "because a process patentee can prevent the use of his patented process by domestic manufacturers directly, their primary effect will be on foreign manufacturing." The above resolution is consistent with the expressed intent of all of these bills.

For the above reasons, our Section strongly supports the provision of S. 1535 pertaining to the scope of protection to be afforded to United States process patents.

Foreign Filing License Requirement Changes

At the 1983 Annual Meeting in Atlanta the Patent, Trademark and Copyright Section adopted the following two resolutions:

> RESOLVED, that the Section of Patent, Trademark and Copyright Law favors in principle a broadening of the remedial provisions for retroactive grant of license for foreign filing under 35 U.S.C. §184, and
>
> Specifically, the Section favors legislation amending 35 U.S.C. §184 to provide that the license may be granted retroactively where an application has been filed abroad through error without

> any deceptive intent and the application does not disclose an invention within the scope of Section 181 of this title.
>
> RESOLVED, that the Section of Patent, Trademark and Copyright Law favors in principle an amendment to 35 U.S.C. §184 clarifying the circumstances in which an applicant for patent shall be relieved of the obligation to seek a license with respect to any modifications, amendments, or supplements to an earlier filed application, and
>
> Specifically, the Section favors legislation amending 35 U.S.C. §184 to add the following further, and final sentence:
>
> "In the case of an application for which a license has been obtained, or which has been filed in the United States for more than six months, a license shall not be required for any modifications, amendments, or supplements to said application, provided that such modifications, amendments, or supplements only illustrate, exemplify or explain such matter previously disclosed, specifically or generically, in said application."

These resolutions are thus in support of the provisions of S. 1535 which pertain to licenses for foreign filing.

Under 35 U.S.C. 184, as it now stands, a foreign patent application may not be filed on an invention made in the United States until six months after the U.S. application has been filed on the invention, unless an express license has been obtained from the Commissioner of Patents and Trademarks authorizing earlier foreign filing. The penalty for filing a foreign patent application within the six month period without a license from the Commissioner is harsh. The right to obtain the United States patent is lost, and if the United States patent has issued, it becomes invalid. There is also a criminal sanction although it is rarely, if ever applied, except possibly for violations involving national security.

The Patent Code does contain amelioration in that the Commissioner may grant the foreign filing license retroactively where an application has been inadvertently filed abroad and the application does not disclose an invention involving national security. However, as the case law has developed, the statutory requirement of inadvertence has prevented the Commissioner from granting relief for certain unintentional violations which have no effect on national security. Also, the license requirement may necessitate a new license be obtained if changes need to be made in foreign applications after they are filed.

In our view, S. 1535 would overcome the difficulties and unfair results of the present law, by amending the Patent Code in respect to licenses for foreign filing.

The change in the standard for the grant of a retroactive license to be effected by Sec. 2, paragraph (1) of the Bill from one of inadvertence to one of error with no deceptive intent is significant. It is supported by our first Resolution and it would, for example, relieve the harshness to an applicant or patentee in situations such as that presented in In re Gaertner, 604 F.2d 1348, 202 U.S.P.Q. 714 (C.C.P.A. 1979). In that case, an applicant's continuation-in-part patent application was rejected because foreign counterparts of the continuation-in-part patent had been filed without a license within six months of its U.S. filing. However, the U.S. patent or original application had been on file by that time for more than six months. The continuation-in-part patent application differed from the parent application only by adding an example showing the use of a known starting material to produce compounds, which material was not disclosed in the original application, but was well within the generic claim already present in the parent case. Gaertner's counsel, as discussed in fn. 6 of the reported decision, had considered whether a license was necessary and had come to the good faith conclusion that it was not. Applying a strict construction to the license-to-file statute, the C.C.P.A. affirmed the rejection of all claims in the application.

The present language, which permits retroactive grant of the license where an application has been "inadvertently" filed abroad without grant of a license, does not provide relief for an applicant, such as Gaertner, who had considered whether a license was necessary and intentionally but mistakenly decided that it was not. Changing the requirement from inadvertence to "error without deceptive intention" would broaden the availability of a retroactive license, applying the C.C.P.A. constructions of that term as found in its reissue cases. Such cases extend to an intentional act which is erroneous but not motivated by deception, In re Wadlinger, et al., 496 F.2d 1200, 181 U.S.P.Q. 826 (C.C.P.A. 1974).

Thus, the changed standard provided by paragraph (1) of Section 2 of S. 1535 which is also applied to issued patents under Section 3, is a most desirable modification of the Patent Law.

The amendment provided by paragraph (2) of Sec. 2, which is supported by our second Resolution would relieve the overly strict requirement of 35 U.S.C. 184 that a Commissioner's license must be obtained for any modification or supplements to the foreign applications. The proposed amendment provides some latitude to allow for changes which only illustrate or exemplify the matter previously disclosed, specifically or generically, in the earlier application, thereby to avoid the harshness of the result obtained in Gaertner. Such changes while providing more detail and being helpful to the U.S. applicant in his quest for foreign patent coverage are by their nature not of concern to national security, and there is no reason to continue any requirement for a Commissioner's license to be obtained before they can be made. The amendment to the statute would eliminate senseless paper work for both the applicant and the Patent and Trademark Office, and will remove an unjustified risk from the shoulders of United States applicants who also file abroad.

In our view, Section 4 of the Bill is also very desirable in its proposal to remove the present criminal sanction unless national security is involved.

In summary, we believe that legislation is particularly appropriate at this time of expanding worldwide markets to enable United States inventors to solicit foreign patent coverage effectively without risking a bar to their U.S. patent rights for conduct which does not involve national security. Failure to procure a license because of error without deceptive intent, and minor changes to a foreign application should no longer be allowed to be the cause for an applicant to lose his United States patent rights.

For the above reasons, our Section strongly supports the provisions of S. 1535 pertaining to licenses for foreign filing.

S. 1841 Provisions Relating to Licensing of Intellectual Property

We have been led to believe that your Subcommittee is also considering at least Titles III and IV of S. 1841. With regard to some of the aspects of those Titles, there is more than a Section position; there is an American Bar Association position on which we shall comment.

In passing, it may be of interest to note that our Section has been granted authority to support broadly the position of the Section of Antitrust Law relative to S. 1841. Although we lack detailed resolutions and positions in some specific areas covered by their Report, it is significant that these two Sections which have historically had different points of view are in agreement, particularly with regard to support for the joint venture research legislation of Title II. The Patent, Trademark and Copyright Law Section of the American Bar Association endorses the support by the Section of Antitrust Law of the passage of Titles II, III and IV as set out in "REPORT OF THE AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW ON THE "NATIONAL PRODUCTIVITY AND INNOVATION ACT OF 1983", adopted February 3, 1984 (copy attached and marked Exhibit A).

While the American Bar Association as a whole has not taken a detailed position on the specific provisions of S. 1841, the subject matter thereof, and particulary Titles III and IV, has been of grave concern to the Association for at least some thirty years and has been the subject of various resolutions of the directed to the encouragement of innovation in research and development activities and the clarification of the law relating to the licensing of intellectual property rights.

In particular, the American Bar Association House of Delegates adopted in 1967 a resolution reading as follows:

> RESOLVED, That the American Bar Association approves in principle legislation by which:
>
> (a) The licensable nature of patent rights would be clarified by specifically stating in the patent statute that applications for patents, patents, or any interests therein may be licensed in the whole, or in any specified part, of the field of use to which the subject matter of the claims of the patent are directly applicable;
>
> (b) A patent owner shall not be deemed guilty of a patent misuse merely because he agreed to contractual provision or imposed a condition on a licensee, which has (1) a direct relation to the disclosure and claims of the patent, and (2) the performance of which is reasonable under the circumstances to secure to the patent owner the full benefit of his invention and patent grant;
>
> (c) It is made clear that the "rule of reason" shall constitute the guideline for determining patent misuse, and be it further
>
> RESOLVED, That the Section of Patent, Trademark and Copyright Law is authorized to communicate this action to members and committees of Congress and to others concerned with enactment of legislation to which the subject matter of this resolution is directed.

This resolution contains the essence of Recommendation XXII of the President's Commission on the Patent System established by Executive Order No. 11215 on April 8, 1965, and which presented its report in November, 1966.

Later specific positions were adopted by the Association's Patent, Trademark and Copyright Section in the light of the then current legislative proposals. These subsequent specific positions in principle emphasized the need for clarification of the law relating to patent licensing (1972), called for application of the "rule of reason" in governing practices involved in such licensing (1973 and 1974) and favored licensing upon any condition which is reasonable within the reward which the patentee is entitled to secure (1974).

Our Section has a history of activity with respect to this subject matter going back to the 1966 report of the President's Commission on the Patent System and its officers have had the privilege of testifying before the Senate Committee on the Judiciary with respect to that subject matter in 1968 and 1971.

We interpret this resolution in general support of the provisions of Titles III and IV of S. 1841. However, it is true that there are not detailed resolutions by our Section so that I must infer the support for the details from the general trends within the Section. It is somewhat more difficult to do this when Copyright is involved, but by analogy, it seems fair to say that the provisions of these titles even those bearing on Copyright are in line with the intent of the resolution quoted above. Since it may be helpful in considering the history of bills which have been considered by prior Sessions of Congress, I enclose an article "A Funny Thing Happened on the Way..." by George W. Whitney (Exhibit B).

Conclusion

While our Section is somewhat limited by the broad language of its resolutions, our resolutions are frequently drawn before the legislation to which they are applicable. I will be pleased to answer questions to the best of my ability about aspects of the pending legislation. I also expect that Mr. George Whitney who has worked on the background relative to S. 1841 will be with me and available to answer questions.

SUMMARY OF STATEMENT

I. The Section of Patent, Trademark and Copyright Law Supports Provisions of S. 1535 §271 of Title 35 of United States Code to Include and Add the Following New Provision

Whoever without authority imports into or uses within the United States a product made in another country by a process patented in the United States shall be liable as an infringer.

A. This Section supports S. 1535, first paragraph of Section 1 but proposes modification that the product must be made during the term of the patent to be an infringement.

B. This Section has no position relative to the proposal to add to §271 the paragraph f provided by S. 1535.

C. To the extent that Title IV of S. 1841 is consistent with S. 1535 and the above stated position the Section supports the purpose of Title V of S. 1841.

II. This Section of Patent, Trademark and Copyright Law Supports the Provisions of S. 1535 Relating to Obtaining Licenses to File Patents Abroad

A. This Section supports Section 3 of S. 1535 permitting granting of retroactive licenses where the failure to procure such license was through error and without deceptive intent and the patent does not disclose subject matter within the scope of §181 of Title 35.

B. This Section supports Section 2 of S. 1535 which makes it unnecessary to obtain additional licenses for modifications, admendments, supplements, divisions or other information filed in or transmitted to the foreign country in connection with an application already in compliance with licensing requirement where such additional information is only illustration and simplification comparison or explanation the subject matter already disclosed in the application.

III. The Section of Patent, Trademark and Copyright Law Does Not Have Authority to Comment on Other Portions of S. 1535 but Such Lack of Authority Should Not Be Construed as Opposing Such Sections.

IV. Relative to Titles III and IV of S. 1841 the American Bar Association Has a Long Standing Resolution Relative to Relaxing Misuse Determinations in Connection with Various Licensing Procedures.

A. The provisions of Titles III and IV of S. 1841 may be reasonably construed to fall within the broad purposes of the ABA resolution and are therefore supported.

B. The provisions of Titles III and IV of S. 1841 relating to copyrights by analogy can be said to bear on the same problems and therefore are supported.

Exhibit A

REPORT OF THE AMERICAN BAR ASSOCIATION
SECTION OF ANTITRUST LAW
ON THE "NATIONAL PRODUCTIVITY AND
INNOVATION ACT OF 1983"

Adopted February 3, 1984

INTRODUCTORY STATEMENT

On February 3, 1984, the Council of the Section of Antitrust Law of the American Bar Association adopted this Report on the "National Productivity and Innovation Act of 1983." As more fully discussed herein, the Section of Antitrust Law supports the passage of Titles II through V of the Act, subject to certain proposed modifications and qualifications. These views are being presented only on behalf of the Section of Antitrust Law and have not been approved by the House of Delegates of the Board of Governors of the American Bar Association, and should not be construed as representing the position of the ABA.

I. INTRODUCTION

In September 1983, President Reagan proposed legislation entitled the "National Productivity and Innovation Act of 1983" (the "Act"). The Act has been introduced in the Senate as S. 1841 and in the House of Representatives as H.R. 3878.* The proposed legislation is intended to modify the antitrust, patent and copyright laws in a manner that will enhance the Nation's productivity and the ability of U.S. industry to compete in the world market. The legislative package is part of a larger Administration program designed to encourage private sector research and development activities by improving the economic and legal climate for such efforts.

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* The Administration's bill and the Administration's analysis of the bill, as reported in 45 Antitrust & Trade Regulation Report (BNA) 397-401 (September 15, 1983), are attached as Appendix A to this Report. Copies of S. 1841 and H.R. 3878 are attached as Appendix B and Appendix C, respectively.

The Section of Antitrust Law of the American Bar Association endorses proposed legislation and other measures designed to accomplish these objectives. In particular, the Antitrust Section supports the passage of those elements of the Act which are reasonably calculated to promote legitimate research and development activities by clarifying the standards under which legality of such activities will be judged and modifying those statutes and doctrines which, as actually applied or as perceived, may tend unduly to inhibit such activities. This Report will set forth the Antitrust Section's position respecting the principal elements of the Act.

II. SUMMARY OF RECOMMENDATIONS

A. The Antitrust Section supports the passage of legislation (in particular, Title II of the Act) which provides that no joint research and development program shall be deemed illegal *per se* in any action brought under the antitrust laws, and which limits damages in actions brought under Section 4 or Section 4C of the Clayton Act to actual damages in cases based on conduct that is part of a joint research and development program. The Antitrust Section opposes the notification provisions contained in Section 203 and 204 of Title II, however, and it does not believe that the detrebling provisions should be conditioned on the specified notification procedure. The notification provisions should be deleted from the Act.

B. The Antitrust Section supports the passage of legislation (in particular, Title III of the Act) which provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws, and which limits damages to actual damages in actions based on such agreements brought under Section 4 or Section 4C of the Clayton Act. The Antitrust Section believes, however, that Title III should be amended to exclude agreements to convey rights to use trademarks from the coverage of the Title.

C. The Antitrust Section supports the passage of legislation (in particular, Title IV of the Act) which provides that conduct cannot be found to constitute patent or copyright misuse on the basis of its possible effect on competition unless such conduct violates the antitrust laws. Title IV should be amended, however, to clarify that the party asserting misuse need not satisfy antitrust standing or antitrust injury requirements to be entitled to raise the misuse defense.

D. The Antitrust Section endorses the resolution relating to process patent legislation adopted by the Section of Patent, Trademark and Copyright Law of the American Bar Association at its 1983 Annual Meeting. The Antitrust Section therefore supports the passage of legislation (in particular, Title V of the Act) which grants process patentees the right to exclude others from using or selling products made by the patented process to the extent that such legislation applies to products made by the patented process which are imported into the United States.

III. DISCUSSION

A. Title II: Joint Research and Development Programs

Title II of the Act is intended to promote research and development activities by clarifying the antitrust standards by which the legality of joint research and development programs will be judged. Title II provides that no joint research and development program shall be deemed illegal per se under the antitrust laws, thus ensuring that "rule of reason" analysis will be applied in assessing the legality of such programs. The proposed legislation defines a "joint research and development program" to mean theoretical analysis, exploration or experimentation, or the extension of scientific knowledge into practical application, such as the development of prototypes. Under Title II, such programs may also include the establishment of research facilities, the collection and exchange of research information, the prosecution of patent applications, the granting of licenses and any other conduct reasonably necessary and appropriate to such program.

The Antitrust Section endorses the Administration's proposal that the per se standard be deemed inapplicable to joint research and development programs. The proposed legislation, if enacted, would not change the substantive standard for determining the legality of joint research and development programs. Rather, the legislation would merely codify the existing "rule of reason" standard that has been consistently applied in assessing the legality of such programs. It does, however, eliminate the possible application of inconsistent legal standards and any corresponding uncertainty (whether or not well-founded) as to the precise standard to be applied. In so doing, the proposed legislation will promote legitimate joint research and development programs.

The Antitrust Section also supports the passage of Section 203 of Title II, which limits damages to actual damages (plus prejudgment interest, court costs and attorneys' fees) in actions brought under Section 4 or Section 4C of the Clayton Act based on conduct that is part of a joint research and development program. Title II would modify the existing statutory requirement that plaintiffs' damages be trebled in all actions brought under Sections 4 and 4C of the Clayton Act.

The Antitrust Section supports the damage limitation provisions of Title II because the existing treble damage requirement may tend to overdeter legitimate joint research and development activities. The actual damages approach contained in Title II would eliminate this overdeterent potential, yet allows victims of unlawful practices to recover their actual damages. Moreover, Title II preserves antitrust plaintiffs' ability to recover "the cost of suit, including a reasonable attorney's fee." Nor does the the proposed legislation affect a plaintiff's ability to seek appropriate injunctive relief pursuant to Section 16 of the Clayton Act. Thus, Title II's modification of the existing treble damage requirement will promote legitimate joint research and development activity while permitting the effective prosecution of meritorious antitrust claims and providing the victims of unlawful practices with compensation for any actual damages sustained.

Title II conditions the availability of its detrebling provisions upon the filing of a prescribed notification disclosing the joint research and development program with the Attorney General of the United States and the Federal Trade Commission. The notification procedure is set forth in Section 204 of Title II.

The Antitrust Section opposes this notification requirement and recommends that Title II be amended to delete the notification provisions contained therein. The disclosure option provided for in Sections 203 and 204 of Title II is undesirable for several reasons. First, advance disclosure of the features of a research and development joint venture is not needed to protect third parties as long as single damages remain available to compensate persons who may later be injured by the operation of the venture. Second, public disclosure may deter companies from taking advantage of the detrebling provisions of the Act and may in fact present a greater disincentive to the formation of research and development joint ventures than do current perceptions of possible antitrust exposure. Third, the disclosure provision -- with publication requirements, withdrawal rights and confidentiality procedures -- adds unnecessary complexity to the bill, and may lead to the imposition of a regulatory burden on the Antitrust Division, the Federal Trade Commission and the business community. Fourth, non-disclosure of the joint research and development program could conceivably give rise to a negative inference respecting the legality of the program in subsequent litigation despite the fact that the participants had independent business reasons for opting against the notification procedure.

More fundamentally, the disclosure provision does not appear to be necessary to protect against potentially anticompetitive conduct. The extremely limited number of cases concerning research and development joint ventures and of government enforcement actions challenging joint research activity suggests that most research and development joint ventures do not pose such serious anticompetitive risks as to warrant a separate advance notification procedure. Correspondingly, experience in the field provides no rational basis for conditioning detrebling upon advance notification.

For the foregoing reasons, the Antitrust Section recommends that Title II be amended to delete the notification provisions contained therein.

B. Title III: Intellectual Property Licensing Arrangements

Title III of the Act would add a new Section 27 to the Clayton Act, providing that "[a]greements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal *per se* in actions under the antitrust laws." Title III also would limit damages in antitrust cases based on such agreements to actual damages, plus prejudgment interest.

The Antitrust Section supports the passage of Title III of the Act, but believes that agreements to convey rights relating to trademarks should be excluded from the legislative proposal. Subject to this qualification, the Antitrust Section believes that Title III will promote research and development activity and access to the fruits of such activity by other parties.

Title III complements Title II by placing single-firm licensing activities on an equal footing with joint research and development programs with respect to the appropriate antitrust standard to be applied and the damages allowable where challenged practices are found to be anticompetitive. Single-firm research and development activities and licensing practices incident thereto should not be subject to a more exacting standard, nor subject to a higher level of potential exposure, than joint research and development programs.

Moreover, the Antitrust Section supports the passage of Title III (subject to the exclusion of trademark licensing arrangements) for reasons independent from its logical nexus with Title II. The ability to license proprietary technology is an important component of a legal system conducive to innovation. See U.S. Department of Justice, Detailed Analysis of Antitrust Legislative Reforms Proposed by the Department of Justice (March 1983). Impediments to licensing arrangements, including the perceived antitrust risks incident to such arrangements, can deter research and development activities by reducing the commercial attractiveness of R&D efforts. Further, such impediments can limit access to proprietary innovations developed by other parties, thereby reducing the potential for more widespread commercialization of the innovation and limiting the number of persons engaged in searching for improvements thereon.

By ensuring that the legality of intellectual property licensing arrangements will be judged under rule of reason analysis, Title III of the Act promotes reasonable, commercially attractive licensing arrangements. Similarly, by limiting antitrust damages based on such arrangements to actual damages, Title III eliminates the overdeterrent potential of the existing treble damage requirement.

It is essential to note that Title III will not allow practices which are proven to be anticompetitive to escape condemnation under the antitrust laws. Proscription of the per se approach will merely oblige the courts to receive evidence concerning the probable economic effects of a challenged practice before ruling upon the antitrust legality of the practice. Further, the remedial provisions contained in Title III, like the corresponding provisions in Title II, will permit the prosecution of meritorious antitrust claims and will provide the victims of unlawful conduct with compensation for their actual damages.

Finally, the provisions of Title III are limited to "[a]greements to convey rights to use, practice or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how or other intellectual property." Title III therefore leaves undisturbed the per se rules and treble damage remedy available to plaintiffs arising out of other alleged violations of the antitrust laws. Thus, a naked agreement in restraint of trade would remain subject to the per se standard and the treble damage remedy even if a licensing agreement were adopted as a means of implementing the basic agreement, since the cause of action attacking the basic agreement would not be "based" on the licensing agreement.

As proposed by the Administration, Title III would apply to agreements conveying rights to use trademarks as well as the other enumerated types of intellectual property. As previously noted, the Antitrust Section believes that Title III should be amended to delete the reference to "trademarks" in proposed new Section 27(a) of the Clayton Act and to expressly exclude trademarks from its terms. Unlike the other types of intellectual property listed in Title III, trademarks are legally protected indicators of origin which are primarily related to the marketing of goods, as opposed to research and development efforts. As a result, trademarks are not properly within the same technological innovation framework which supports the other provisions of the Act.

C. Title IV: Patent Misuse

Title IV of the Act would amend 35 U.S.C. § 271 to provide that enumerated patent practices cannot provide the basis for a finding of misuse or illegal extension of the patent unless such practices, in the circumstances in which they are employed, violate the antitrust laws. These practices include:

> (1) licensing the patent under terms that affect commerce outside the scope of the patent's claims (e.g., requiring a licensee to purchase unpatented materials from the licensor, requiring a licensee to assign to the patentee a patent that may be issued to the licensee after the licensing arrangement is executed, restricting a licensee's freedom to deal in products or services outside the scope of the patent, requiring the licensee to become a licensee of a second patent);
>
> (2) restricting a licensee of the patent in the sale of the patented product or in the sale of an unpatented product made by the patented process;
>
> (3) obligating a licensee of the patent to pay royalties that differ from those paid by another licensee or that are allegedly excessive;
>
> (4) obligating a licensee of the patent to pay royalties in amounts that are not related to the licensee's sales of the patented product or an unpatented product made by the patented process;
>
> (5) otherwise using the patent in a manner that allegedly suppresses competition.

Title IV would also enact corresponding amendments to federal copyright law under 17 U.S.C. § 501(a).

The Antitrust Section supports these proposed amendments to 35 U.S.C. § 271 and 17 U.S.C. § 501(a). The proposed modification of the misuse doctrine is a necessary element of the Act's overall purpose of encouraging intellectual property licensing and, correspondingly, investment in research and development activities. It would be inconsistent to limit damages for antitrust violations in the context of licensing arrangements, on the one hand, and yet leave undisturbed a misuse doctrine which confronts intellectual property holders with the prospect of being unable to enforce their patents or copyrights because of economic provisions in licensing agreements which do not even constitute antitrust violations. Moreover, the proposed limitation on the misuse doctrine, on its own merits, would represent a positive development in the context of the patent/antitrust interface.

At the outset, it should be noted that Title IV would not alter existing law with respect to the misuse doctrine as it applies to improper practices not related to competition (e.g., fraud on the Patent Office). Rather, Title IV would merely ensure that a meaningful economic analysis has been performed before a court properly may refuse to enforce a valid patent or copyright under the misuse doctrine as applied to practices which are allegedly anticompetitive.

In the patent/antitrust context, two basic lines of patent misuse cases have developed. The primary line involved efforts to use the patent to control commerce outside the scope of the patent claims. See, e.g., Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488, reh. denied, 315 U.S. 826 (1942). The second principal line of misuse cases involved practices related to products covered by the patent. See, e.g., Ansul v. Uniroyal Inc., 448 F.2d 872, 880 (2d Cir. 1971); F.C. Russell Co. v. Comfort Equipment Corp., 194 F.2d 592, 596 (7th Cir. 1952).

In both lines of cases, the courts found the patent owners guilty of misuse essentially on the grounds that the challenged practices were anticompetitive in effect and, therefore, contrary to public policy. Indeed, in Morton Salt the Supreme Court's holding was expressly premised on its finding that the patent had been used "as a means of restraining competition." 314 U.S. at 493. See also Mercoid Corp. v. Minneapolis Honeywell Regulator Co., 320 U.S. 680, 684 (1943), reh. denied (1944) ("The legality of any attempt to bring unpatented goods within the protection of the patent is measured by the antitrust laws not by the patent law.").

Although this aspect of the misuse doctrine is grounded in national economic policy as expressed in the antitrust laws, the courts have stated that various forms of allegedly "anticompetitive" conduct may constitute patent misuse despite the fact that the conduct does not violate the antitrust laws. See, e.g., Morton Salt Co. v. G.S. Suppiger Co., supra. As a result, these cases treat market power derived from patents more harshly than market power derived from other lawful means. For example, these cases would deny a patent owner the ability to enforce its patent on grounds of misuse even though the challenged conduct falls short of an antitrust violation, but an identical practice employed in the context of a know-how license might well be enforceable. Compare A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710, 715 (9th Cir. 1968) with Robintech, Inc. v. Chemidus Wavin, Ltd., 628 F.2d 142, 146-49 (D.C. Cir. 1980).

The Antitrust Section believes this aspect of the misuse doctrine is undesirable and should be addressed by appropriate legislation. It is by no means clear that all practices by which a patent holder seeks fully to exploit its patent rights are necessarily anticompetitive in purpose or effect. In fact, this aspect of the misuse doctrine is inconsistent with sound competition policy because it can deter procompetitive or otherwise desirable conduct. Moreover, the doctrine may inhibit research and development investment by precluding commercially attractive licensing programs.

Where licensing activities contravene national competition policy as expressed in the antitrust laws, a finding of misuse should follow. On the other hand, conduct should not be condemned as patent misuse on economic grounds unless the conduct is inconsistent with the antitrust laws. Title IV codifies these principles, and the Antitrust Section supports this proposed modification of the misuse doctrine.

Title IV should be amended, however, to make clear that the proposed modification does not incorporate the antitrust requirements of standing or antitrust injury into the misuse doctrine. In other words, it should be made clear that the party asserting misuse need not satisfy antitrust standing and antitrust injury requirements to raise successfully the misuse defense. A finding of misuse should be supportable wherever the substantive quality of the conduct violates the antitrust laws without regard to whether the party asserting misuse could properly bring a private antitrust action on the basis of that conduct. The Antitrust Section therefore recommends that Title IV be amended to provide that the enumerated practices cannot provide the basis for a finding of misuse unless such practices "would be found to violate the antitrust laws if challenged by the Department of Justice."

D. Title V: Process Patents

Title V of the Act would amend 35 U.S.C. §§ 154 and 71 to expand the exclusive rights of a process patent holder to products made by the patented process. The proposed amendment to Section 154 grants to process patentees the right to exclude others from using or selling such products; the proposed supplementary amendment to Section 271 makes the use or sale of such products infringement.

Under existing law, a process patentee can prevent the use of the patented process by domestic manufacturers by means of an infringement action under 35 U.S.C. § 271, but he cannot prevent the use or sale of unpatented products made by the process. A manufacturer who employs a process outside the United States to produce unpatented products is not liable as an infringer of a United States patent on the process, despite the fact that the products are ultimately sold in the United States. University Patents, Inc. v. Questor Corp., 213 U.S.P.Q. 711 (D. Colo. 1981), citing Clairol, Inc. v. Brentwood Industries, Inc., 193 U.S.P.Q. 683 (C.D. Cal. 1976). As a result, a process patent owner does not have any civil remedy against a manufacturer who uses the process outside the United States to make products sold in the United States.*

Title V of the Act would close this gap in United States process patent protection by providing that the use or sale of unpatented products of a patented process would constitute an infringement of the patented process. The Antitrust Section supports the passage of Title V to the extent that the proposed amendments to the Patent Code are necessary to provide process patent owners with an effective civil remedy against the importation into the United States of products manufactured in another country by a process patented in the United States.

The Antitrust Section is not prepared, however, to support this extension of a process patent owner's rights to situations in which the use of the process occurs in the United States. Under existing law, process patent owners already have a cause of action against persons using patented processes within the United States and such patentees, through discovery, have adequate means to determine whether the processes being used are within their patent grants. Thus, while the need for legislation with respect to foreign practice of patented processes is demonstrable, it is less clear that such a need exists with respect to domestic process use. Since Title V will expose retailers, distributors and users of unpatented products made by patented processes to charges of infringement, the Antitrust Section believes that the legislative response should be confined to those situations in which a clearly defined need for remedial legislation has been shown to exist.

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* Although a limited form of relief may be available to the process patent owner through the United States International Trade Commission pursuant to 19 U.S.C. § 1337, et seq., the procedural hurdles, evidentiary burdens and limited relief available in USITC proceedings have rendered this avenue of redress largely ineffective.

In this regard, the Antitrust Section endorses the following resolution which was adopted by the Section of Patent, Trademark and Copyright Law at it 1983 Annual Meeting:

> Resolved, that the Section of Patent, Trademark and Copyright Law favors in principle the enactment of legislation to provide that whoever imports into the United States or uses or sells in the United States a product made in another country by a process patented in the United States and made during the term of that patent shall be liable as an infringer.

The Patent, Trademark and Copyright Section's resolution embodies the notion that the legislative response to the process patent problem should be limited to imported products at this time, and the Antitrust Section concurs for the reasons discussed above.

IV. CONCLUSION

The Antitrust Section believes that the various provisions of the Act are reasonably calculated to promote domestic research and development activities in a manner that is consistent with national competition policy as embodied in the antitrust laws. Subject to the suggested modifications and qualifications set forth in this Report, the Antitrust Section supports the passage of the Act.

Exhibit B

"A FUNNY THING HAPPENED ON THE WAY . . ."

The Search for Reason in Patent Law

by

George W. Whitney*

For almost thirty years the patent bar has sought clarification of the law relating to patent licensing and the application of the "rule of reason" to patent licensing to obtain for the patentee the reward which he is reasonably entitled to secure. A glimmer of hope appeared last year in the first session of the 98th Congress. It burns more brightly now and there is a small window of time left within the final session of the 98th Congress to achieve that goal, at least in part.

A short time ago on February 28th, House Judiciary Committee Chairman Peter W. Rodino, in introducing H.R.4963, stated that "a salutary national purpose would be served by legislation sending a clear signal to American business that the antitrust laws are not an obstacle to participation in properly-limited R & D joint ventures." He placed H.R.4963 on a "fast track" (after mark-up it was renumbered H.R.5041) with bipartisan sponsorship.

Many of the features of Title II of the Reagan Administration's bill, H.R.3878, are found in the Rodino bill, just one more of the surfeit of similar bills introduced in both Houses of Congress. For those who are intently following this flurry of Congressional activity, there is a serious question: which, if any, of these bills should be targeted as having even a small chance of being seriously considered by both Houses of Congress before the political urgencies of a Presidential election year absorb all other energies. As of this writing, Rodino H.R.5041 and an amended S.1841 with Titles III & IV deleted may be the vehicle.

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*Partner in Brumbaugh, Graves, Donohue & Raymond, and Chairman of Committee 403.

A unique situation has existed during the past year that would suggest that there is a strong chance of success in the passage of such legislation. Both Houses of Congress are concerned with America's loss of its dominant position in the technological world. They are quite vocal on the need to encourage innovation whether it be by individual or corporate efforts, joint research and development activities or government funded projects. On the Administration side, the leadership of the Commerce Department and the Justice Department have throughout the past year personally appeared on the Hill and stressed the urgent need for such legislation. In September 1983, the Administration forwarded to Congress with much fanfare proposed legislation (S.1841 and H.R.3878) which attempted to take into account the comments and concerns of industry and interested elements of the bar, as well as those of members of Congress and their legislative staffs. Hearings had been held earlier in the year on related bills seeking to encourage research and development by reducing fear of antitrust liability and treble damages.

Thurmond S.1841 was given a "fast-track" on the Senate side. The Secretary of Commerce and the Assistant Attorney General in charge of the Antitrust Division promptly testified in support of the bill. They strongly endorsed Title II - encouragement of joint research and development programs, Title III - application of the "rule of reason" to the conveyance of intellectual property rights, and Title IV - clarifying the application of the doctrine of misuse in cases of infringement of the patent and copyright laws.

Notwithstanding the interest and concern of the Administration and Congress, there simply has not been the strong constituency from industry and the patent bar needed to give Congress the necessary impetus to pass the bill. The Section at the 1983 Meeting in Atlanta, acting on a concern that it had evidenced for almost thirty years, sought to provide a means for enabling it to play an appropriate role in what then happened to be a fast-track, but rather ambiguous, legislative effort. The Section passed three resolutions favoring in principle the Congressional and Administration efforts to address these clearly important areas involving the interface of the patent and antitrust laws. Because of the uncertainties of the legislative effort and the concern with overreaching to fix something that arguably might not be "broke", the section strengthened an established liaison with the Antitrust Section and awaited the Administration's legislative package.

As soon as the package arrived, both the PTC and the Antitrust Sections got to work through their existing committees to specifically address Titles II, III and IV of the Administration bill as the legislative vehicles most likely to be considered. The task was to carefully follow the activity on both the House and Senate sides and to present recommendations to the section councils at their respective mid-year meetings in January and the first week in February. PTC's Committee 403 with very few abstentions overwhelmingly supported the Administration proposal on encouraging joint research and development programs (Title II) by a vote of 37 to 5. The Committee also approved a resolution supporting Title III by a vote of 33 to 10 and Title IV by a vote of 31 to 12. These resolutions provided the PTC Section's Council with significant guidance on issues raised by the Antitrust Section at its earlier January Mid-Winter Council Meeting and its subsequent request for "blanket authority" to endorse with certain modifications the Administration legislative proposal.

While the Administration sought to have all three Titles treated as a package, the vagaries of legislative action, as of this writing, appear to be moving them forward along separate paths. For example, though Congressman Moorhead introduced the Administration bill, H.R.3878, he now is a co-sponsor of the Rodino bill, H.R.5041. Furthermore, the new Assistant Attorney General, J. Paul McGrath, has indicated that the Justice Department will support the Rodino bill and it is quite possible that Congress, in the light of seemingly widespread bipartisan support for the substance of Title II, may pass that legislation this year. The picture is neither that clear nor that strong for Titles III and IV.

To some, all this flurry of activity may appear to be something new, yet literally thousands of man-hours have been invested by interested members of the bar in efforts to establish a reasonable development of the law in this highly important area. For almost thirty years, the bar has sought to clarify the interface between the sometimes seemingly inconsistent underlying principles of the patent and antitrust laws within the constitutionally based public policy of encouraging innovation in a freely competitive society.

The importance of what is being considered today can only be fully appreciated by an understanding of the background starting from a point such as 1955 when a half-century of legal precedent in the patent/antitrust area was summarized in the Report of the Attorney General's National Committee to Study the Antitrust Laws. That document sought to recognize the law as it then existed and endorsed the correctness of positions, including the "rule of reason" that are entirely consistent with the legislative proposals now before the Congress twenty-nine years later.

It may well be true that Congressman Rodino is right when he says that the "record evidence" today does not support industry's contention of a threat to technological leadership because of a decline in research and development activities through inhibition by the antitrust laws. But he is also right when he goes on to state "the perception is more important than the reality". Not only is that true today, it has been true over the past thirty years.

Subsequent to the codification of the Patent Law under Title 35, United States Code, in 1952, the patent/antitrust interface became a matter of concern both to the Patent Bar and the Antitrust Bar. While the Attorney General's 1955 Study Report endorsed the "rule of reason", the case law was developing in a different and confused direction. Efforts were underway to reverse, modify or "clarify" the 1926 decision of the Supreme Court in the General Electric case. In addition, a great many problems began to surface relative to the patent system generally.

The PTC Section responded by establishing a special Committee on Patent Systems Policy Planning. Shortly thereafter, on April 8, 1965 by Executive Order, a President's Commission on the Patent System came into being with fourteen members, only two of whom were from the Patent Bar. The remaining members were well known researchers, inventors, academicians, businessmen and attorneys. One of the co-chairmen was a former federal judge. The then Commissioner of Patents also sat on that Commission. Its final report submitted on November 17, 1966 included among many specific recommendations, quite a few of which have been implemented, Recommendation XXII. That Recommendation, made some sixteen years ago, initiated a seven-year spate of activity and controversy on the legislative front, within the Administration and in the Patent and Antitrust Bars. It is also directly relevant and substantially similar in scope to the current Administration proposals in Titles III and IV.

The first paragraph of Recommendation XXII specifically states:

"The licensable nature of the rights granted by a patent should be clarified by specifically stating in the patent statute that: (1) applications for patents, patents, or any interests therein may be licensed in the whole, or in any specified part, of the field of use to which the subject matter of the claims of the patent are directly applicable, and (2) a patent owner shall not be deemed guilty of patent misuse merely because he agreed to a contractual provision or imposed a condition on a licensee, which has (a) a direct relation to the disclosure and claims of the patent, and (b) the performance of which is reasonable under the circumstances to secure to the patent owner the full benefit of his invention and patent grant. This recommendation is intended to make clear that the "rule of reason" shall constitute the guideline for determining patent misuse."

The Administration moved rapidly on the Commission Report and in three months submitted to Congress proposed legislation on the general revision of the Patent Laws (S.1042 and H.R.5924, 90th Congress); nothing was included on Recommendation XXII. The Bar responded with a massive effort within the next three months to consider the Report of the President's Commission and the Administration proposals. In April, 1967, the PTC Section called a special meeting in Washington, D.C. to develop its position. Following that meeting it immediately started work on drafting a comprehensive ABA bill for the general revision of the Patent Laws which would include Recommendation XXII.

The following month, the APLA held an unusual three-day meeting in Boston to consider the recommendation of its Committees and membership with respect to the Commission Report and the Administration bills. On May 18, the PTC Section Chairman testified before the Senate Judiciary Subcommittee on Patents, Trademarks and Copyrights requesting affirmative action to enable the formalization and completion of the Section's proposals. A week later the Chairman-elect of the Section and the Chairman of its Special Committee on Patent Systems Policy Planning charged with the responsibility of drafting the ABA bill appeared before the appropriate House Judiciary Subcommittee. The APLA President testified before the House Subcommittee two weeks later.

The major effort then moved on to Honolulu, the site of the August, 1967 Annual ABA Meeting in which the House of Delegates on recommendation of the PTC Section expressly endorsed the substance of Recommendation XXII in a resolution directly paraphrasing the Commission's recommendation.

The ABA bill was introduced in the Senate on October 30, 1967 as Dirksen S.2597 and in the House on November 9 as Poff H.R.13951. It contained a proposed Section 263 which substantially tracked Recommendation XXII and the ABA resolution.

Matters continued to move at a fast pace in the beginning of the second session of the 90th Congress, with a letter to the Senate Judiciary Committee on January 24, 1968 from the General Counsel of the Department of Commerce officially opposing Recommendation XXII and Section 263. Hearings began on January 30th before the Senate Subcommittee with the Acting Secretary of Commerce, the Department's General Counsel and the Commissioner of Patents in opposition. The Chairman of the PTC Section accompanied by the Chairman of its Special Drafting Committee testified in support of S.2597 and, in particular, Recommendation XXII and Section 263. A corresponding amendment had been submitted to the Administration bill.

The following day the President of the APLA spoke in support of the ABA position, the ABA bill and expressly endorsed the need for Recommendation XXII and Section 263. A month later the Justice Department through the Deputy Attorney General submitted a written report in support of the Commerce Department's position in its opposition to Section 263.

The 91st Congress began a year later with the Administration bill being resubmitted, still without a Section 263 or any effort to implement Recommendation XXII. Substantial efforts were being made throughout the Bar to reconsider the substance of Recommendation XXII and develop a possibly more definitive approach. At the end of 1969 and beginning of 1970 the APLA with the support of the Philadelphia Patent Law Association proposed as a substitute for Section 263 significant amendments to Section 261 and Section 271 directed to exclusive field of use licensing, non-exclusive cross-licensing and use of royalties in any amount that might differ from that agreed to with other parties and might cover single or package licensing of patents.

An ad hoc bar group, excoriated by a nationally syndicated Washington columnist as the "foxes guarding the hen house", produced an alternative proposal. That proposal, with substantial Amendments to Sections 261 and 271, was introduced by Senator Scott as Amendment No. 578 to the Administration bill, S.2756. It became known as one of the "Scott Amendments" and included a provision directed to the right of the assignor and parties to a license to challenge the validity of the underlying patent, as well as provisions for grant back of non-exclusive licenses under improvements, the computation of royalties on a basis convenient to the parties and a statutory base for specifically defined licensing practices. At the end of the 91st Congress on November 5, 1970, the PTC Section Chairman wrote to the Senate Subcommittee strongly supporting Recommendation XXII and attaching a brief seeking to put Section 263 into the Administration bill S.2756. During the 91st Congress, a highly significant split had developed between the Commerce Department and the Patent Office, which now jointly supported the principles of Recommendation XXII, and the Antitrust Division of the Justice Department, which even more vigorously opposed those principles.

The first session of the 92nd Congress began with a great deal of activity leading up to Senate Subcommitee Hearings on the Scott Amendments on May 11 - 13 of 1971. Following the introduction of the general revision bill S.643 which did not include the substance of Recommendation XXII or Section 263, one of the "Scott Amendments" was again introduced as Amendment No. 24 to S.643. It was identical to the proposal made in the 91st Congress and was directed to substantial amendments of Sections 261 and 271 of Title 35.

The Commerce Department with the help of interested members of the Patent Bar submitted, in advance of the hearing, a detailed position paper. The Under Secretary of Commerce, accompanied by the Commissioner and Assistant Commissioner of Patents testified in support of the Scott Amendments with some modification, urged application of the "rule of reason" and supported the 1926 Supreme Court decision in the G.E. case. The same day the Assistant Attorney General in charge of the Antitrust Division, accompanied by the Chief of the Patent Unit of the Antitrust Division, testified in strong opposition to the Scott Amendments, opposed the "rule of reason" approach and noted the impending overruling of the 1926 General Electric case.

The former Commissioner of Patents (1964-69) then testified in strong support of Recommendation XXII and the principles of the Scott Amendments and the need for clarifying the confusion that existed as a result of the actions and pronouncements of the Antitrust Division of the Justice Department and the Federal Trade Commission. Noting that he had been a member of the President's Commission, he called attention to the recommendation of the Commission and the need to codify the present law to create a greater certainty not only for business but for the courts and the Justice Department.

The Assistant Attorney General on behalf of the Antitrust Division had earlier testified that "the uncertainty which does exist is merely the necessary price for the maintenance of flexibility in detail with important and complicated issues of public economic policy." On June 2, 1971 the Under Secretary of Commerce, as requested, wrote to the Senate Judiciary Subcommittee citing specific examples of conflict with the Justice Department and statements of the Justice Department officials that "contributed to confusion".

The ABA did not present a statement in those hearings on the Scott Amendments, but a letter from the then PTC Section Chairman requesting the opportunity to appear and citing the 1967 Association position that paraphrased Recommendation XXII was made of record. Furthermore, correspondence from his predecessor with an accompanying brief on the need for statutory provision in this area was also included in the record.

The record over the three-day hearing in 1971 on the "Scott Amendments" in which many representatives from industry, government, academia and the Patent and Antitrust Bars participated is highly instructive and exhaustive. Certainly it is directly in point in any consideration of Titles III and IV and, in fact, in respect to Title II of the current Administration proposal.

A period of relative quiet ensued on the legislative front for almost ten years until a spokesman of the Justice Department's Antitrust Division indicated a significant change in thinking with respect to the fundamental policies and interface of the Patent and Antitrust Laws. The pendulum had swung completely from a time when both the Commerce Department and the Justice Department in 1968 opposed the efforts of industry, the Patent Bar and many others who addressed the then urgent need for statutory clarification of the Patent/Antitrust Law; and in 1971, when the two departments of the Executive Branch split assunder in what was at times a bitter confrontation. Congress, faced with the uncertainties created by that confrontation, did not act. We are almost now at the far end of that pendulum swing since we have not only a strong interest and concern on the part of Congress but unanimity in the Administration and the two key departments of the Executive Branch in direct support of the principles of Recommendation XXII and the formal ABA position, both now seventeen years old. The word "almost" is appropriate because the Bar, possibly in an overindulgence in caution and possibly with a feeling that it had burned itself out in the early '70s, has not taken the aggressive role that it did in that earlier period.

However, the current positions of the Antitrust Section and the PTC Section give a strong signal to Congressman Rodino that there is a problem of concern, even if it is only with a matter of perception. In view of the current position of the Justice Department and recent case law, there is a need to address the problem and finally provide a statutory answer.

It has been a long path and it would be a shame if we missed the boat again. There is clearly evidence from the above detailed history, that economic policies and practices, the positions of governmental agencies and individuals, as well as the decisions of the courts do radically change with time, even if the underlying principles have not. If we are really interested in preserving or reacquiring a position of dominance in the world of technological innovation, we cannot afford to gamble. We must redouble our efforts to amend the antitrust laws.

American Bar Association

April 5, 1984

Senator Charles McC. Mathias, Jr.
Chairman of the Subcommittee on Patents,
Copyrights and Trademarks of the
Senate Judiciary Committee
United States Senate
Washington, D.C. 20510

Re: S. 1535 - Mathias

Dear Senator Mathias:

During my oral testimony at the hearing of your Subcommittee on Tuesday, April 3, 1984, I indicated that, contrary to the statement in my outline, the Section of Patent, Trademark and Copyright Law has a 1973 resolution which supports the proposal of Section 1 of your bill to add the stated paragraph (f) to 35 U.S.C. Section 271. I had discovered its existence in a final review of materials in preparation for the hearing. Therefore, the resolution did not appear in my prepared testimony. However, the presentation of the resolution has now been cleared at ABA Headquarters.

Therefore, in accordance with the following resolution, our Section urges that Section 1, paragraph (f) of S. 1535 be approved by your Subcommittee:

> RESOLVED, that the Section of Patent, Trademark and Copyright Law approves in principle the term "infringement" of a patent to include the unauthorized supplying of the essential unassembled components of a patented invention in the United States for delivery outside of the United States: and SPECIFICALLY, the Section approves the following to be added as a part of Section 271 of Title 35, U.S. Code: Except as otherwise provided in this title, whoever without authority supplies or causes to be supplied, unassembled, in the United States for delivery outside of the United States, the essential components of any patented invention, during the term of the patent therefor knowing or intending that the components are to be assembled, so that when assembled the assembly if it has occurred in the United States would constitute infringement in the United States, infringes the patent.

SECTION OF PATENT, TRADEMARK AND COPYRIGHT LAW 1983-1984
1155 EAST 60TH ST., CHICAGO, ILLINOIS 60637 • TELEPHONE (312) 947-4000

CHAIRMAN
John C. Dorfman
Ste 1310
123 S. Broad St
Philadelphia PA 19109

CHAIRMAN-ELECT
Rudolph J. Anderson, Jr
P.O. Box 2000
Rahway, NJ 07065

VICE-CHAIRMAN
Julius Jancin, Jr
7815 Fulbright Ct
Bethesda, MD 20817

SECRETARY
Ronald B. Coolley
Ste 4200
20 N. Wacker Dr
Chicago, IL 60606

ASST TO THE SECRETARY
Roger N. Coe
Miles Labs
P.O. Box 40
Elkhart, IN 46515

DIRECTOR OF FINANCE AND BUDGET
Thomas E. Smith
Ste. 950
150 S. Wacker Dr
Chicago, IL 60606

ANNUAL PUBLICATIONS EDITOR
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COUNCIL MEMBERS

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One Thomas Circle, NW
Washington, DC 20006

LAST RETIRING CHAIRMAN
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Chicago, IL 60603

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David Goldberg (1986)
605 Third Ave
New York, NY 10158

Jack C. Goldstein (1986)
P.O. Box 4433
Houston, TX 77210

Douglas B. Henderson (1985)
1775 K St., NW
Washington, DC 20006

Karl F. Jorda (1985)
444 Saw Mill River Rd
Ardsley, NY 10502

I. Fred Koenigsberg (1987)
ASCAP
One Lincoln Plaza
New York, NY 10023

William Marshall Lee (1984)
Ste. 950
150 S. Wacker Dr
Chicago, IL 60606

John E. Maurer (1987)
800 N. Lindbergh Blvd
St. Louis, MO 63167

Pauline Newman (1984)
FMC Corp
2000 Market St
Philadelphia, PA 19103

Joseph J. Previto (1984)
Empire State Bldg
New York, NY 10001

Albert Robin (1987)
Ste. 220
1270 Ave. of the Americas
New York, NY 10020

John K. Uilkema (1985)
2001 Ferry Bldg
San Francisco, CA 94111

BOARD OF GOVERNORS LIAISON
William H. Neukom
Ste. 1000
Norton Bldg
Seattle, WA 98104

STAFF LIAISON
Michele A. Kukowski
American Bar Center
1155 E. 60th St
Chicago, IL 60637
312/947-3869

I regret that our Section will not be able to consider some of the other Sections of S. 1535 before this summer's meeting. However, many are to be considered and, if the legislation remains pending, we will seek blanket authority and communicate such further support as quickly as we can to you at that time.

Incidentally, a typo in the Summary outline of my Testimony under subject I. subparagraph C. may be misleading. At least on my copy the "IV" in line 1 of subparagraph C. should be --V--.

One other thing may be of interest: The full text of my testimony beginning in line 5 of page 4 discusses the inadequacy of ITC proceedings as a remedy which Mr. Engelberg suggested was sufficient. I believe that no one else discussed the ITC remedy during oral presentation relating to Section 1 proposed paragraph (e) to 35 U.S.C. §271. This discussion may be of some interest as the testimony is reviewed.

The offer of George Whitney and myself to supplement the information presented about S. 1841 stands if you or any of your Subcommittee or the respective staffs would like to develop this subject further.

On behalf of the Section of Patent, Trademark and Copyright Law of the American Bar Association, again, please accept our thanks for allowing me and Mr. Whitney to appear and give testimony before your Committee.

Sincerely yours,

John C. Dorfman

JCD:jmc

cc: ABA/PTC Section Officers
George W. Whitney, Esq.
Harry F. Manbeck, Jr., Esq.
John E. Mauer, Esq.
Alfred B. Engelberg, Esq.
Mrs. Michele A. Kukowski

American Bar Association

CHAIRMAN
John C. Dorfman
Ste 1310
123 S. Broad St
Philadelphia, PA 19109

CHAIRMAN-ELECT
Rudolph J. Anderson, Jr
P.O. Box 2000
Rahway, NJ 07065

VICE-CHAIRMAN
Julius Jancin, Jr
7815 Fulbright Ct
Bethesda, MD 20817

SECRETARY
Ronald B. Coolley
Ste 4200
20 N. Wacker Dr
Chicago, IL 60606

ASST TO THE SECRETARY
Roger N. Coe
Miles Labs
P.O. Box 40
Elkhart, IN 46515

DIRECTOR OF FINANCE AND BUDGET
Thomas E. Smith
Ste 950
150 S. Wacker Dr
Chicago, IL 60606

ANNUAL PUBLICATIONS EDITOR
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Christian Science Center
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NEWSLETTER EDITOR
Zachary S. Flax
2606 Spencer Rd
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COUNCIL MEMBERS

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Chicago, IL 60603

William H. Elliott, Jr (1986)
Ste 3131
12 S. 12th St
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605 Third Ave
New York, NY 10158

Jack C. Goldstein (1986)
P.O. Box 4433
Houston, TX 77210

Douglas B. Henderson (1986)
1775 K St., NW
Washington, DC 20006

Karl F. Jorda (1985)
444 Saw Mill River Rd
Ardsley, NY 10502

I. Fred Koenigsberg (1987)
ASCAP
One Lincoln Plaza
New York, NY 10023

William Marshall Lee (1984)
Ste 950
150 S. Wacker Dr
Chicago, IL 60606

John E. Maurer (1987)
800 N. Lindbergh Blvd
St. Louis, MO 63167

Pauline Newman (1984)
FMC Corp
2000 Market St
Philadelphia, PA 19103

Joseph J. Previto (1984)
Empire State Bldg
New York, NY 10001

Albert Robin (1987)
Ste 220
1270 Ave. of the Americas
New York, NY 10020

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2001 Ferry Bldg
San Francisco, CA 94111

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William H. Neukom
Ste 1900
Norton Bldg
Seattle, WA 98104

STAFF LIAISON
Michele A. Kukowski
American Bar Center
1155 E. 60th St
Chicago, IL 60637
312/947-3869

April 23, 1984

The Honorable Charles McC. Mathias, Jr.
Chairman of the Subcommittee on Patents,
Copyrights and Trademarks of the
Senate Judiciary Committee
United States Senate
Washington, D.C. 20510

Re: Supplement to Testimony on Behalf of the American Bar Association Patent, Trademark and Copyright Law Section April 3, 1984 about S. 1841

Dear Mr. Chairman:

I just read the enclosed talk of Assistant Attorney General McGrath in the Patent, Trademark and Copyright Journal of April 12, 1984 (Vol. 27, No. 675) over the Easter weekend. I thought this might be particularly interesting to your Subcommittee in view of opinions expressed by me and George Whitney that there had been a major change in climate since the days of the old Scott Amendments. The American Bar Association Antitrust Division is on record supporting S. 1841 in the paper attached as Exhibit A to my testimony. Mr. McGrath's talk seems to confirm, as we had opined, that not only are the Antitrust Law and the Patent, Trademark and Copyright Law Sections of ABA in agreement but the Antitrust Division of the Department of Justice is also in line with our mutual views.

Assistant Attorney General McGrath's paper, in fact, provides specific examples of why he thinks the Antitrust Law should be made clear to require a "rule of reason" standard as opposed to "per se" standard in patent antitrust matters as required by S. 1841.

Thank you, again, for considering our Section's position.

Sincerely yours,

John C. Dorfman

JCD:jmc
Enclosure
cc: Messrs. Manbeck, Maurer, Neukom, Officers and Ms. Kukowski

SECTION OF PATENT, TRADEMARK AND COPYRIGHT LAW 1983-1984
1155 EAST 60TH ST. CHICAGO, ILLINOIS 60637 • TELEPHONE (312) 947-4000

PATENT LICENSING: A FRESH LOOK AT ANTITRUST PRINCIPLES IN A CHANGING ECONOMIC ENVIRONMENT

Remarks by

J. Paul McGrath
Assistant Attorney General
Antitrust Division

Before the

Seminar Services International Conference
on U.S. Patent Practice

Crystal City, Virginia

April 5, 1984

These are changing economic times — times that present important challenges both to the United States government and to its people. One of the major economic changes, and one that has received considerable media attention, is increased foreign competition, not only in overseas markets but in domestic markets as well. The onset of this serious competition makes it all the more important that our laws do not unreasonably restrict the ability of United States firms to compete. Today I would like to discuss one aspect of the law that, I believe, has unnecessarily hampered the competitiveness of our industry — the hostile manner in which the government and the courts have evaluated patent licenses under the United States antitrust laws. I will briefly discuss the importance of technological development to our economy, then explain the important economic benefits that can result from patent licensing, the past problems with government and judicial decision-making in the area, and finally the proper analysis of patent licenses under the antitrust laws.

It is difficult to overstate the importance of technological advance to this country's economic welfare. Technological advance has a direct and positive effect on the competitiveness of American industry, on the productivity of American labor, and on the well-being of American workers and consumers. It has been estimated that over the last 80 years, technological progress has accounted for almost one-half of the growth in per capita real income. More generally, companies that invest heavily in the research and development of new technologies have about three times the growth rate, twice the productivity rate, one-sixth the price increases, and nine times the employment growth as companies with relatively low investments in such R&D. In addition, development of new technology can significantly improve our balance of trade. Since the 1960s our balance of trade in technology-intensive products has been far more favorable than the trade balance for other products. Advances in technology are therefore a key element in finding a solution to some of the most vexing problems of the last decade: unemployment, inflation, declining real income, and a deteriorating balance of trade.

While the United States has been, and no doubt continues to be, the leader in the creation and development of new technologies, we have witnessed in the last 10 to 20 years increasingly intense competition in this area. During the decade of the 1970s, the rate of growth of this country's investment in R&D (excluding national defense) as a percentage of GNP declined, at the same time that the trends in R&D investment of other important economic rivals such as Japan and Germany steadily rose. Japan and Germany now invest a larger percentage of their GNP in non-defense R&D than the United States.

If United States industry is to grow and prosper and to compete effectively with the industries of other countries, we must reverse this trend. Our economy must encourage greater investment in R&D. To achieve this, we must provide adequate economic incentives for the creation and development of new technologies.

Inherent in the innovation process are obstacles that — unless overcome — tend to sap the willingness of industry to invest in R&D. First, R&D, which can be tremendously expensive, is extremely risky. Even if R&D actually results in an invention or innovation — and that is by no means a sure thing — there is no guarantee of commercial success. Only the Patent Office and God know how many patent owners who believe they have invented the proverbial "better mousetrap" are sitting alone, waiting for the world to beat a path to their door. Even those inventions and innovations that do reach the marketplace are most often only marginally profitable.

The risk associated with R&D is exacerbated by the fact that it can be very difficult for the creators of new technologies, even very valuable ones, to earn a profit from the benefits their technology provides the economy. This is due to the fact that it can be difficult to prevent others from copying technological information. If I let someone borrow my better mousetrap, he can use it — and I can't — until it is returned. However, if I lend someone the plans describing the technology required to make the better mousetrap, he can continue to use that technology to make his own mousetraps or to instruct others how to make the mousetrap even after the plans have been returned. Without the legal right to prevent the unauthorized dissemination of information, it might be very difficult for me to find anyone who would pay me for my new mousetrap technology — why pay when you can get it free!

To encourage the development of new technologies in the face of these obstacles, we provide inventors with exclusive, though limited, rights to the technology they create. While the exclusive rights are provided by a whole range of intellectual property laws, the most important exclusive rights are those provided by the patent laws. In effect, a patent is the brass ring for which inventors compete. The first one to invent a new technology — that is to grab the ring

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— gets the right to exclude others from using the technology for 17 years. If others wish to use the technology, they must meet the terms set by the patent owner. In this way, the patent owner earns a reward for his or her R&D investment that approximates the value that society places on the technology.

Although this reward may make some inventors very rich, tremendous success is rare. Nonetheless, the few successes serve as the incentive for countless other inventions and innovations that, while individually only marginally profitable, are collectively essential to a strong, vibrant economy.

Obviously, then, if our economy is to provide adequate incentives for private sector R&D, the owners of technologies must be allowed to earn a profit with no less vigor than the owners of tangible property. Similarly, to ensure the maximum benefit from technology, the law should encourage, not discourage, the extensive and rapid dissemination of technology. To accomplish these objectives, it is often necessary for patent owners to license their technology. And it is in the area of licensing that the antitrust laws most seriously affect the patent laws.

The freedom to license is important in numerous ways. First, carefully conceived licensing schemes often provide patent owners with the best means to maximize the reward provided by their patent. An example of such a licensing practice is the "tie-in." A tie-in provision essentially conditions the license of a patent — or the sale of a product or service that embodies the technology — upon the licensee's agreement to purchase some other related good or service from the patent owner. Tie-ins sometimes can restrict competition; however, they often have salutary competitive effects, increasing both the profits from, and the availability of patents.

Let me describe two examples of the economic benefits of a tie-in. Potential licensees might be unwilling to obtain a license for a technology if they are uncertain as to the technology's utility. If, on the other hand, an owner can license his or her patent at a low price and make a profit on the sales of some item used in conjunction with the invention, the owner and licensee could share the risk that the invention might prove to be useless. If the invention is very useful, the licensee will require a large number of the related items, and the owner will receive a large reward. If, however, the licensee is unable to use the invention, the licensee will require very few of the related items and will have to pay very little.

Similarly, a tie-in can allow the owner of technology to meter differences in demand among various licensees and to obtain higher payments from licensees who value the technology more and lower payments from licensees who value the technology less. The ability to engage in such metering will increase the patent owner's reward and thus the incentives to invest in R&D in the first place. In addition, it can also increase the invention's dissemination by enabling a potential licensee, who is unwilling to pay the single price the patentee would charge if there were no metering, to gain access to the invention.

Licensing also can be economically beneficial by permitting the patent owner to bring products embodying a patent to the marketplace in the quickest, most efficient manner possible. Often the patent owner will not be in a very good position to develop a patent on its own. For example, the inventor of a new technology may not have adequate manufacturing facilities or an effective distribution system in place. In such cases, through licensing the patent owner can combine his or her skills with the superior production or marketing skills of others. By permitting patent owners to obtain efficiencies in manufacturing, production and distribution, licensing can be the key to ultimate competitiveness of a patented product in the marketplace. Indeed, the cost savings from licensing can mean the difference between success and failure.

To ensure the efficient development of a patent, it is often necessary to restrict the licensee's use of the patent. Though there are many such potentially procompetitive restrictions, today I will describe only one — the field-of-use restraint. A field-of-use restraint used when a patent has applications in more than one technological area, such as the transistor which proved to have uses in fields ranging from the simple pocket radio to the most complex computer. A field-of-use restraint limits a particular licensee to practicing the invention in a particular field or fields. In this sense, a field-of-use restraint can be viewed as preventing competition because it has the effect of prohibiting various licensees from competing with each other when practicing the patented invention. In fact, however, these restraints can be dramatically procompetitive.

It is rare that the inventor of a technology that has potential uses in many fields is in a position to take advantage of each use with maximum efficiency. Competition is best served if the patent owner licenses the firm (or firms) that can develop the patent most efficiently for each potential use. Once the "raw" technology is in the hands of these licensees, they often must invest substantial time, effort and money in R&D and other activities before the technology is transformed into a commercially attractive product or service. Thus the licensees must invest in "mini-innovations" if the technology is to realize its potential in any given field of use.

If the licensee faces the possibility that other licensees will be in a position to copy its mini-innovations and thereby to compete in its area of expertise, the licensee may not have the incentive to invest in developing these mini-innovations in the first place. The exclusive field-of-use license can be used to ensure that the licensee has the proper incentive. By granting the exclusive right to use the technology in a particular field, the patent owner induces the desired investment in further innovation that is necessary to exploit all the potential uses of the technology.

Tie-ins and field-of-use restrictions are only two of a myriad of licensing practices. In general, these practices can improve competition by increasing the legitimate reward to inventors and by permitting patented inventions to reach the marketplace at the earliest time and at the lowest possible cost.

The availability of a broad range of patent licensing practices also ensures that other firms will have access to new technology. To the extent that the law restricts the range of licensing options, patent owners may be less willing to enlist other firms to aid in the commercialization of their technology. Very often the enlisted firms are small businesses. Without licensing, these small businesses may be foreclosed from new markets. With licensing, these firms not only benefit immediately but also in the longer term are exposed to technologies that may stimulate them to create and develop other technologies.

In short, then, if United States firms are going to be in a position to compete effectively in the marketplace, they must be free to license their patents. American firms should not be hamstrung by antiquated antitrust doctrines that unreasonably restrict their ability to secure efficiencies through patent licensing. Unfortunately, however, there is a history of court decisions and government pronouncements that tend to discourage such desirable patent licensing.

The hostility to patent licensing contained in these decisions and pronouncements seems to have its roots in a conclusion that the patent grant of exclusive rights is in inherent conflict with a competitive market system. The grant to patent owners of the right to exclude others from practicing an invention has been viewed as a monopoly, in obvious friction with the antitrust laws which discourage formation of monopolies. These notions find considerable support in Supreme Court decisions. The Court has depicted the patent system as inherently in conflict with antitrust goals and has labeled the patent grant as a "monopoly,"[1] the limits of which are to be "narrowly and strictly confined,"[2] so as to avoid the "evils of expansion" of the patent monopoly by private contracts.[3] Following this lead, in examining the lawfulness of a patent license under the antitrust laws, one lower court recently stated that "[the patent grant] is in inevitable tension with the general hostility against monopoly expressed in the patent laws.... Therefore courts normally construe patent rights narrowly in deference to the public interest in competition."[4] The Antitrust Division of the Department of Justice took a similarly anti-patent stance in the early 1970s — which it has since repudiated — when it enunciated its now infamous rule, known to most of you as the "nine no-nos" of patent licensing.[5]

More recent decisions of the Supreme Court involving the issue of the patentability of inventions demonstrate an increased sensitivity to the economic benefits flowing from the patent grant.[6] However, to date the Court has not done much to clean up the confusion in the area of licensing. In fact, the Court seems to have taken a step backwards in its decision last week in the *Hyde* case.[7] The facts of the case involved a tying arrangement. No patents were involved, but the majority opinion went out of its way to describe in dictum the way tying rules should apply when patents are involved. I would like to read to you one paragraph of the opinion that embodies some of the misconceptions about patents and patent licensing that have led to an overly restrictive antitrust doctrine in this area. The Court stated:[8]

> [I]f the government has granted the seller a patent or similar monopoly over the product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power. Any effort to enlarge the scope of the patent monopoly by using the market power it confers to restrain competition in the market for the second product will undermine competition on the merits in that second market. Thus, the sale or lease of a patented item on condition that the buyer make all his purchases of a separate tied product from the patentee is unlawful.

This discussion is troublesome in two ways. The first is the notion that "it is fair to presume that" market power necessarily flows from a patent grant. This presumption reflects the traditional, though ill-conceived, notion that the patent laws create "monopolies" that are inherently in conflict with the competition policy underlying the antitrust laws. The truth is, however, that the exclusive rights to patents rarely give their owners anything approaching a monopoly. Patented items almost always compete vigorously with products that are not covered by the patent. As I noted above, it is not unusual that a patent is so insignificant that its owner is unable to earn any profit at all.

However, even when a patent turns a profit — in economic terms, earns "rents," — that does not necessarily indicate that the patent produces market power about which the antitrust laws should be concerned. In the real world, as opposed to the economists' world of theory and mathematical models, rents are being earned all the time, even where there is vigorous competition. For example, because some competitors in a market are more efficient than others, the more efficient will earn larger profits than their rivals. These profits should no more be condemned than the rents earned by the owner of a process patent that discloses a method of producing an existing product at a substantial cost savings.

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[1] *See, e.g.*, United States v. Line Material, Inc., 333 U.S. 287 (1988); Mercoid Corp. v. Mid-Continent Co., 320 U.S. 661 (1944); Ethyl Corp. v. United States, 309 U.S. 436 (1940); Carbice Corp. v. American Patent Co. v. Universal Film Mfg. Co., 243 U.S. 502 (1917).

[2] Mercoid Corp. v. Mid-Continent Co., 320 U.S. at 665.

[3] *Id.*

[4] United States v. Studiengesellschaft Kohle, m.b.H., 670 F.2d 1122, 1127 (D.C. Cir. 1981).

[5] Remarks of Bruce Wilson, Department of Justice Luncheon Speech, "Law on Licensing Practices: Myth or Reality?" (January 21, 1975). The Antitrust Division repudiated that approach, *see, e.g.*, Remarks of Abbott B. Lipsky, before the American Bar Association Antitrust Section "Current Antitrust Division Views on Patent Licensing Practices" (November 5-6, 1981); Remarks of Roger B. Andewelt before the Houston Patent Law Association "Basic Principles to Apply at the Patent-Antitrust Interface" (December 3, 1981).

[6] *See e.g.*, Diamond v. Chakrabarty, 447 U.S. 303 (1980); Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176, *reh'g denied*, 448 U.S. 917 (1980), *on remand*, 557 F.Supp. 739 (S.D. Tex. 1983).

[7] Jefferson Parish Hospital District No. 2 v. Hyde, No. 82-1031, ___ U.S. ___ (March 27, 1984).

[8] Slip Op. at 13 (citation omitted).

Furthermore, by holding out the promise of a financial reward, the patent system encourages the creation of inventions that otherwise would not occur or would not occur as quickly. The patent grant thus promotes competition even when it creates monopoly or market power because it brings new choices and lower prices to consumers.

The important point that is lost in the *Hyde* dictum is that it is no more proper to presume that patents create market power than to presume that all property, tangible or intangible, creates market power. Whether or not a patent produces any market power is a factual question that can only be resolved by the same detailed economic analysis that would be required to determine whether any other asset produced market power.

The second troubling notion in the majority opinion is that it seems to rely on the suggestion in certain earlier Supreme Court decisions that licensing arrangements that in any way affect products outside the scope of the patent are inherently suspect under the antitrust laws. This simply is not true.

A patent is merely one of many inputs that may be involved in bringing a particular product to the marketplace. As I mentioned before in my discussion of tying, sometimes the most efficient way for a patent owner to bring the technology to the marketplace is to market it in a manner that affects other necessary, but unpatented inputs. The search for such efficiencies should not be condemned simply because commerce outside the patent claims is effected.

Moreover, a focus on whether the license affects commerce outside the scope of the patent ignores the economic reasoning of *GTE Sylvania*.[9] Because the technology embodied in a patent should be viewed as an input in the manufacture of a product, a patent license generally constitutes a vertical arrangement — that is, an arrangement between different links in the production chain. In *GTE Sylvania*, the Supreme Court stressed that in the context of vertical arrangements restrictions on one party's competitive conduct often will be procompetitive. The Court therefore required that a factual analysis of the competitive effects of all vertical restrictions, except resale price maintenance, be undertaken before those restrictions are condemned under the antitrust laws. Thus, the notion that patent license restrictions should be condemned merely because they affect commerce outside the scope of the patent raises form over economic substance and ignores the important teaching of *GTE Sylvania*.

This brings us to what may be the main reason you invited me to address you today — to explain how I believe patent licenses should be evaluated under the antitrust laws. Put in the simplest terms, patent licenses, including those that restrict a licensee's competitive conduct or affect products outside the scope of the patent, should not be viewed as inherently suspect or *per se* unlawful under the antitrust laws. Patent licenses should be subjected to antitrust scrutiny that is no harsher than that employed for a transaction involving any other type of asset. The lawfulness of patent licenses should be based on a factual economic analysis, and licenses should be deemed unlawful only when their overall effect is anticompetitive. Toward this end, the President has proposed legislation, titles III and IV of the National Productivity and Innovation Act, that would ensure that intellectual property licenses are not condemned under the antitrust laws or under the misuse doctrine without appropriate consideration of their procompetitive benefits.

How should the analysis of licensing restrictions proceed? The first step in any antitrust analysis is to define the market affected by the license — in antitrust terms, the relevant market. We do this by a fairly complex process described in detail in our *Merger Guidelines*.[10] In essence the outcome of this process is to define relevant markets to include not only the individual technologies or products covered by the patents but also available and potentially available substitutes for these technologies or products. These substitutes are a part of the analysis because they serve as a potential block on anticompetitive conduct. If a licensing practice would otherwise have the effect of raising the prices of the underlying technologies or products, the availability of substitutes would mean that potential licensees and consumers could turn to other technologies or products and thus make the price increase unprofitable.

Because there are substitutes for most patents, the relevant market will typically be broader than the scope of the patent itself. This general approach to defining a relevant market was employed by the Supreme Court in the *Walker Process* case.[11] There the Court recognized that to determine whether an alleged fraudulent procurement of a patent amounted to an antitrust violation, it was necessary to define the relevant market to include substitutes. The Supreme Court explained: "Without a definition of that [relevant] market there is no way to measure [the patentee's] . . . ability to lessen or destroy competition."[12] This lesson is equally true when patent licensing rather than patent fraud is involved.

Once the relevant markets are defined, the competitive effects of the patent license in those markets must be analyzed. A key part of this analysis will be a determination whether the patent owner or its licensees alone or in combination have power in the market. As I noted previously, the fact that a technology is patented does not mean that the patent owner necessarily has market power.

If the analysis leads to the conclusion that no market power exists, the patent license generally should not raise antitrust concerns. Of course, there are exceptions — for example, when the license is a cover for a horizontal agreement to fix prices or when the licensing practice is prevalent throughout the industry and those practices collectively have the effect of raising prices or precluding existing or potential competition.

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[9] Continental T.V. Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

[10] U.S. Department of Justice Merger Guidelines (Antitrust Division June 14, 1982), reprinted in Antitrust & Trade Regulation Rep. (BNA) No. 1069, at S-3 (June 17, 1982).

[11] Walker Process Equipment Inc. v. Food Machinery & Chemical Corp., 382 U.S. 172 (1965).

[12] *Id.* at 177.

If the patent and its licensees in combination do have market power, then the analysis should proceed by carefully evaluating the actual or potential effect of the license on competition in the relevant market. One must begin by determining whether the license has any anticompetitive effect. If no anticompetitive effect can be estabilshed, the restriction should not be condemned.

Moreover, if the restriction has no effect other than to restrict commerce in the patented technology or products, the practice generally should not be condemned. The patent grant permits the patent owner to exclude everyone from practicing the patented invention. If the patent owner chooses to license the patent, he or she should not be prevented from earning the maximum reward by exercising this right to exclude in the most efficient manner possible. After all, to the extent the antitrust laws discourage a particular licensing practice, the patent owner may be forced to engage in some less desirable alternative, such as refusing to license the patent altogether. Not only would this decrease the efficiency with which the patent is exploited but also would reduce the expected overall return to R&D.

The main focus of the inquiry should be whether the licensing practice has an adverse competitive effect on products or technologies that actually or potentially compete with the patent. For example, a licensing scheme may be used to increase the barriers to entry into a market. Also, prevalent licensing may have the effect of suppressing competing technologies and thereby limiting competition and limiting the choices available to consumers. In short, there must be a fact intensive inquiry to determine whether the licensing practice has had an anticompetitive effect in some properly defined market.

Even if a restriction in a patent license results in some anticompetitive effect, this does not mean that the restriction is necessarily unlawful. If the challenged restriction is reasonably necessary to achieve some demonstrable procompetitive benefits, then these benefits must be balanced against the anticompetitive effects. Of course, if the particular restriction is not reasonably required to obtain the benefits, then balancing is not necessary — the restriction is illegal.

To sum up, this country is heading into a critical phase in its history, in which it will have to battle successfully in order to avoid being knocked out of market after market — both here and abroad — by foreign competitors. We know we can't hide from competition; we shouldn't erect barriers to keep imports out of our markets. The best choice we have is to meet foreign competition head-on, and to do that successfully we have to free American business from artificial retraints. No single factor will be more important in our race against foreign competitors than our development and application of new technology. That is one area where we can't afford the luxury of old-fashioned ideas, and we in the Department of Justice intend to see that antitrust policy is as modern as the technology it seeks to foster.

Senator Mathias. I am not sure that it helps us that these proposals have a long and venerable history. That raises the question of why the Congress has not acted in the meantime. I have some bitter scars to prove that.

Mr. Whitney. I think, in part, that ties in with the fact, though, that maybe back in 1968 and 1966 and the early seventies we were trying to accomplish too much at one time, and where we got hung up in the fights of that time which ended up unfortunately in some bitter fights between the Justice and the Commerce Departments and the bar and that sort of thing.

Today, we are addressing specifics. We were not specifically turned down at that time, but because it was part of an overall package. Today, I think we should try to move forward with that, which we urge.

Senator Mathias. Of course, today we have incentives that we never had before, facing a $100 billion trade deficit this year and a larger one next year in all probability which should give us the maximum incentive to increase productivity in this country. That is an extremely important national project.

Mr. Whitney. Never before, I think, — at least in the last 15 or 20 years or 30 years have we had such an alignment of both the administration and the departments, the Members of Congress in both Houses, the bar, and others wanting to do something in a common way. And I think we should try to accomplish it.

Mr. Dorfman. Mr. Chairman, also, my point about the antitrust section being in line with the patent section is important. In the past, we have had the antitrust section opposing things that the patent section has sponsored, and very often the Congress has said that if you people cannot agree, how can we decide what to do. I think that is a major change.

Mr. Pravel. Mr. Chairman, would it be permissible for Mr. Benson to make a comment or two with respect to S. 1841? We did not have a comment on that.

Senator Mathias. Yes.

Mr. Benson. Thank you, Mr. Chairman. In our formal statement, you will find only a very brief paragraph referring to this bill, but it does say that we will supplement it. In summary, what I would like to point out is that our position is that the introductory remarks accompanying that bill were very favorable to the patent system.

However, the language of the bill does not track and does not accomplish what is set out in the introductory remarks, and when we submit our statement on this, we will submit some proposed language changes, but conceptually we favor that bill.

Senator Mathias. But you will give us your specific suggestions?

Mr. Benson. I think you said at the beginning of the hearing that we had 3 weeks to do that. We will have it in 3 weeks, yes.

Senator Mathias. We will look forward to getting that additional information. There has been some reference to the Scott amendments in the past history of this subject. It might be useful to define the differences between the Scott amendments and S. 1535. Are any of you prepared to do that or could you give us that subsequently?

Mr. **Dorfman**. I am not prepared to do it, but I can certainly say that the Scott amendments were much more specific. There has been a mutation in the language so that you cannot have the Scott amendments track the language of the current proposal, S. 1841.

The ABA resolution does not track it. We have a little problem making it fit, but, as Mr. Benson says, it is the principle of the thing. There is a consensus now that this is needed. There is a need for support of joint work. There is a need for support of the individual licensee.

If you are going to support a joint venture, I mean, the individual licensor, you certainly need to support that individual licensor as well in the same way, and even though this language—it is very hard, it is very detailed language, both the Scott amendments and the language of the current bill.

Mr. **Whitney**. Mr. Chairman, relative to the question you asked a moment ago, I think if you would refer, or at a later point, refer to page 10 through 13 of the history paper that has been submitted with the ABA position namely, my paper with the title "A Funny Thing Happened on the Way * * * the Search for Reason in Patent Law," that it does direct itself specifically to that question.

And very quickly, what you have is that in recommendation 22 of the Presidential Commission, there was a relatively simple and direct statement that culminated with the approach or the endorsement of a rule of reason approach with misuse and things of that nature.

The ABA endorsement or House position of the ABA in 1968 tracked the language of recommendation 22. There was then a section 263 proposal that was put in the Dirksen bill at that time because recommendation 22 was not included in the administration bill that was put in in the beginning of 1967.

That also tracked the language of recommendation 22 and stayed relatively simple. Then you have the Scott amendments of 5-68 and 5-67 that were introduced a few years later that got far more involved.

And where we got hung up in the quite bitter dialog between the Justice Department and the Commerce Department and others at that time related to a set of very specific points and proposals.

What we have today in S. 1841, in those proposals, is more back to the type of thing that we had originally in proposals for section 263 and also in recommendation 22 of the Presidential Commission. So there has been a swing through that period.

Senator **Mathias**. Well, I will review that section of the history to which you referred the committee.

Mr. Pravel, you oppose section 7.

Mr. **Pravel**. Yes, sir.

Senator **Mathias**. And as I understood your statement, you did oppose it because the Patent and Trademark Office has been in the process of establishing regulations designed to simplify the priority of interference proceedings. Do you want to expand on your opposition to section 7 a little further?

Mr. **Pravel**. Yes, Mr. Chairman. Section 7 is a requirement that the evidence to establish priority of invention shall be by affidavit. In other words, it uses the dogmatic word "shall be provided by affidavit." It precludes proof by deposition testimony or an opportunity for cross-examination and it would, therefore, in our opinion, be less than a full disclosure that should be permitted in terms of establishing priority of invention.

If the Patent Office uses affidavits for a period of time by permission without requiring them so that there is a history then of how they work in that environment perhaps this type of approach could be acceptable at a later date. That is the reason for our statement.

Senator **Mathias**. Is there any other member of the panel who wants to comment on section 7?

[No response.]

Senator **Mathias**. If not, we thank you very much for being here. We appreciate your testifying.

Our third panel will consist of Mr. John E. Maurer, general consulting attorney, Monsanto; Richard C. Witte, chief patent counsel, Procter & Gamble; and John W. Schlicher, Townsend & Townsend.

Gentlemen, do you have any preference as to who goes first?

STATEMENTS OF JOHN E. MAURER, GENERAL CONSULTING ATTORNEY, MONSANTO CO., ST. LOUIS, MO; RICHARD C. WITTE, CHIEF PATENT COUNSEL, THE PROCTER & GAMBLE CO., CINCINNATI, OH; AND JOHN W. SCHLICHER, TOWNSEND & TOWNSEND, SAN FRANCISCO, CA

Mr. **Maurer**. Good morning. My name is John E. Maurer, and I am the general consulting attorney of Monsanto Co.; I am pleased to appear here today on behalf of an Ad Hoc Committee To Improve the Patent Laws. That committee is composed of representatives of 12 major U.S. companies that share an interest in improving the operation of the U.S. patent system. I have also been authorized to state that some 70 U.S. research-oriented industries and institutions support the efforts of our committee.

Our common bond is a strong commitment to research and invention and a dependence upon a strong patent system, and we appear, therefore, in order to give our fullest support to S. 1535 which we see as an effective step in adapting the U.S. patent system to today's problems.

Before proceeding, I would like to take a moment and acknowledge on behalf of the Ad Hoc Committee the valued efforts of one of our members, Dr. Pauline Newman, who is here today. Rightfully, she should be testifying before you. However, as you know, her appointment to the Court of Appeals for the Federal Circuit prevents her further involvement in our efforts. We would, therefore, be pleased for the record to acknowledge her leadership.

Senator **Mathias**. Well, the committee certainly joins you in that recognition. We do not want to put her in a position that she has to recuse herself too often on the bench, but we are happy that she is here today.

Mr. **Maurer**. Thank you.

There is great promise in the introduction of S. 1535. It suggests a new appreciation of the role of the patent system in innovation. The changes proposed by that bill are substantive legislation which should strengthen U.S. patents and thus increase the usefulness of the patent system as the cornerstone of industrial and university innovation.

It will encourage manufacturing within the boundaries of the United States, ease technology transfer through licensing, reduce the administrative burden on patent applicants and on the Patent and Trademark Office and modify some inequitable court decisions.

My written submission to the committee presents the views of the ad hoc committee on each of the sections of S. 1535. In this statement, I would like to emphasize our position on several of the proposed changes.

The amendments to section 271 are intended to support and aid manufacturing in the United States by removing loopholes in present law which encourage product manufacture or assembly of a patented invention outside of the United States.

In particular, new section 271(e) will provide protection under the laws to a patent owner against a person that uses his patented process outside the United States and then imports and sells the product from that process in our country in competition with him. This situation not only allows but promotes the manufacture outside the United States using U.S.-developed technology.

Legislation is also needed in the area of foreign-filing licenses to overcome some unfair aspects of the present law and reduce the burden on patent applicants and the Patent and Trademark Office.

All U.S. inventors wishing to protect their inventions in any foreign country must obtain a license for filing that subject matter abroad. Any deviation from that requirement including the furnishing of supplementary information abroad for a foreign patent application on which a license has already been granted, without obtaining an additional license, can result in invalidation of the corresponding U.S. patent and additionally can bring criminal penalties.

A slightly modified system which S. 1535 proposes can fully meet national security purposes while providing significant cost savings to users of the patent system and to the Patent and Trademark Office, and as importantly, S. 1535 would temper the harshness of the present judicial interpretation of 35 U.S.C. 184.

Furthermore, this legislation is particularly appropriate at this time of expanding worldwide markets to enable U.S. inventors to solicit foreign patent coverage effectively without risking a bar to their U.S. patent rights for conduct which does not involve national security.

The amendments to section 103, we believe, are needed, in order to modernize the patent law by accommodating the realities of the inventive process as practiced in today's world.

In large research laboratories as well as in smaller technology based businesses, there often exists scientific or technological prior knowledge. Team research and its advantages lead inevitably to intermingling of ideas from people to achieve a desired result.

Unfortunately, the law as interpreted in *In re Bass* and other decisions has caused many problems. We believe it is not sound public policy to penalize organizations which take a team approach to the solution of problems.

Another area of concern is the Lear doctrine, which many have talked about this morning, which affects the contract rights of a licensor and which makes those rights basically illusory. We believe that amendment does not block legitimate challenges to licensed patents. On the other hand, it would place the licensor in a fairer position relative to the licensee if a challenge of validity is raised.

Finally, I would like to say we urge passage of the bill, because we believe that all of the changes in title 35 will bring greater predictability, and therefore, reliability to patents and accordingly help to increase the usefulness of the patent system as a national incentive to investment and innovation.

Thank you.

[The following statement was received for the record:]

PREPARED STATEMENT OF JOHN E. MAURER

My name is John E. Maurer and I am General Consulting Attorney of Monsanto Company. I'm pleased to appear today on behalf of an An Hoc Committee to Improve the Patent Laws which was formed in 1981.

That Committee is composed primarily of representatives of 12 major U.S. companies that share an interest in improving the operation of the U.S. patent system. Committee members and their affiliation are identified in an attached list (Exhibit A). Also I have been authorized to state that some 70 United States research-oriented industries and institutions support our efforts. A list of those supporters is also attached (Exhibit B). Our common bond is a strong commitment to research and invention and a dependence upon a strong patent system. We appear, therefore, in order to give our fullest support to S.1535, which we see an effective step in adapting the United States patent system to today's problems.

The amendments proposed in S.1535 represent an overdue approach to remedying some of the lapses and, in some cases, aberrations in our patent system. It is important to remedy these lapses and aberrations because the United States patent system is still the only broad incentive for investment in new and creative ideas and in the industries spawned by these ideas. In some respects the United States patent system has become one of the most expensive systems in the world, and yet is arcane and unreliable. We are concerned because this unreliability is reflected in diminished effectiveness of the patent incentive. It is important to our national interest that we improve, update and strengthen our patent system.

We see great promise in the introduction of S.1535. It suggests a new appreciation of the role of the patent system in innovation. While to some the changes proposed by S.1535 may seem technical and mundane, we who rely on the patent system know their importance. This is substantive legislation which should strengthen national patents and thus support investment in innovation in these times of blossoming technology and changes in world trade patterns. These amendments to the patent law will increase the usefulness of the patent system as the cornerstone of industrial and university innovation. They will encourage manufacturing within the boundaries of the United States, ease technology transfer through licensing, reduce the administrative burden on patent applicants and on the Patent and Trademark Office, and modify some inequitable court decisions.

The principles embodied in the various provisions of S.1535 have received general support from all concerned with the technological strength of the nation. This support has been accompanied by a harmonious development of administrative rules within the Patent and Trademark Office, and the attention of many bar associations in refining the concepts treated in S.1535. It is my firm belief that this group of amendments of the patent law will have a salutary and real affect on technological innovation in the United States.

I'd now like to provide a section-by-section discussion of the purpose and benefits of these proposals.

Section 1. MANUFACTURE IN THE UNITED STATES

This section amends 35 U.S.C. §271 by adding two new statutory sections which are intended to support and aid manufacture in the United States by removing loopholes in present law which encourage product manufacture or assembly of a patented invention outside of the United States.

If a patent owner can obtain a patent on the product produced by a process, the protection afforded by this Section would be unnecessary because the patent owner could then sue for infringement of the product patent. However, in many cases, particularly with respect to chemicals, product protection cannot be obtained because the product is known, yet not economically obtainable. A process which is new, patentable and economically feasible provides a practical way to make the product available to the public. Under the patent law today, however, the owner of a U.S. patent covering a process for making a product has no recourse against a person that uses his patented process outside the United States and then imports and sells the product from that process in our country in competition with the patent owner. Obviously, this situation not only allows, but promotes, manufacture outside the United States using U.S.-developed technology.

Proposed amendment Section 271(e) provides that unauthorized importation into the United States of a product made abroad by a process patented in the United States will infringe the United States patent. The need for this remedial legislation has been apparent for many years. It was recommended in the 1966 Report of the President's Commission on the Patent System and again in the 1979 Domestic Policy Review on Industrial Innovation. The 1966 Report commented as follows:

> "The unauthorized importation into the United States, or sale or use, of a product made abroad by a process patented in the United States, does not now constitute infringement ... This recommendation would make it possible to prevent evasion of the process patent owner's exclusive rights in the United States by the practice of his process abroad and the importation of the products so produced into this country."

Every other major manufacturing country has such a provision in its law. It is inequitable for foreign laws to protect foreign manufacturers against imports of this type without the same benefit being available to United States manufacturers.

The principle is not new to U.S. jurisprudence. It is embodied in 19 U.S.C. §1337(a), the Tariff Act, as a potential unfair method of competition. However, Section 1337(a) is of limited value because there are serious drawbacks to its practical application. For example, it requires an administrative determination of substantial competitive injury to an industry in the U.S. as well as the usual proof of patent infringement and adjudication of patent validity. In addition, the patentee can only obtain an exclusion order and cannot obtain damages for past infringement. Proposed amendment 35 U.S.C. §271(e) would broaden the procedural and substantive remedies available to the patentee in the courts and thus would favor production within the United States of products intended for the United States market.

Some concern has been expressed that under proposed Section 271(e) a party could be an infringer without knowing that the product he has purchased or imported was made by the patented process. Alternatives have been proposed. One proposal would require that there would be no infringement unless the alleged infringer had actual notice that the product was made by the patented process. Other proposals have suggested that the remedy of an injunction should not apply against the sale of products in the possession of the infringer prior to actual notice. It has been suggested that this proposed amendment to Section 271 should be further amended so that it would only apply to a product made during the term of a U.S. process patent. On the other hand, many people feel that such proposals are not fair to the patent owner and that this form of infringement should be treated in the same way that any other patent infringement is treated under the present law. Overall there seems to be broad support for Section 271(e) of S.1535, and we support this provision as presently written.

Another issue has been presented in the Administration Bill (S.1841) and the Moorhead Bill (H.R. 3577). These bills would create a presumption that the imported product was made by the patented process if the patent owner had exhausted all reasonable efforts in the foreign countries to establish that the product sold in the U.S. was made by the U.S.-patented process, thereby shifting the burden of proof to the alleged infringer to establish that the product was not made by the patented process. We note, however, that it is usually easier for an alleged infringer to get information from his supplier than it is for the patent owner to determine the identity of the process used to make a particular product.

But the extent of foreign activities that the patent owner would be required to investigate would, in our view, make this approach unduly expensive and burdensome.

As a corollary to the above, the proposed amendment to 35 U.S.C. §271(f) changes the present law, as interpreted in 1972 in the case of Deepsouth Packing Co. v. The Laitram Corporation, 406 U.S. 518. In Deepsouth the Supreme Court held that a United States patent is not infringed if the final assembly of a patented product occurs outside of the United States, even when all of the components are made within the United States and even when the removal offshore of the final assembly is explicitly for the purpose of avoiding the United States patent. The Supreme Court itself stated that legislative, not judicial, action is required if an innovator/patentee is to have a remedy under such circumstance. Such a remedy was included in earlier omnibus patent bills, including S.2504 in the 93rd Congress and S.473, S.2255, and S.23 in the 94th Congress.

There has been extensive commentary on the Deepsouth holding in connection with hearings on past proposed legislation and in scholarly acticles. The subterfuge permitted by Deepsouth (which the court felt powerless to prevent) is disadvantageous to an innovative economy, encourages offshore manufacture, and is unfair to inventors. It is time to discourage such opportunistic copying and evasion of inventors' rights. We believe S.1535 corrects this unjust situation and protects the export trade incentive for innovative U.S. companies.

It is our understanding that a proposal has been made to delete the concept in Section 271(f) that to constitute infringement a supplier must know that if the components were combined in the United States the combination would be an infringing assembly. Upon reconsideration we believe it would be appropriate to delete this difficult standard of proof. This Section would then be consistent with the standard of proof required to prove infringement of product patents. Also, no inequity would result since under present law notice of infringement is required before damages accrue. Obviously once an infringer has notice he also has knowledge.

Section 2. - FOREIGN FILING LICENSES

Chapter 17 of Title 35 was enacted to control the transmittal abroad of technical information bearing on national security. All United States patent applications, and all supplementary material for foreign patent offices, are reviewed for this purpose by the Patent and Trademark Office, and oftentimes by other U.S. government agencies. When agency inspection indicates that it is appropriate, the application is placed under a secrecy order.

The great majority (estimated at 93% by the Patent and Trademark Office) of patent applications contain no sensitive information relating to national security and are not placed under a secrecy order. Nevertheless all United States inventors wishing to protect their inventions in any foreign country must either obtain a license for filing that subject matter abroad or wait for six months after the U.S. filing after which a license is deemed granted if no secrecy order has been imposed. Any deviation from that requirement, including the furnishing of supplementary information abroad for a foreign patent application on which a license has already been granted (without obtaining an additional license for the supplementary information) can result in invalidation of the corresponding U.S. patent and, additionally, can bring criminal penalties. These penalties can apply even when the subject matter has nothing to do with national security, even when the general subject matter has been granted a license, and even when all the material has already been published. Clearly these penalties amount to overreaction.

Nevertheless, in spite of these penalties, it is not uncommon for patent applicants to sometimes overlook the need to request a new license for supplemental information especially when it is somewhat repetitious in nature. Recognizing the practicalities of the situation, the statute Sec. 184 of the present law authorizes the Commissioner to grant a retroactive license where the material in question has been "inadvertently filed abroad", provided national security interests are not involved. Unfortunately, court interpretation of Sec. 184 has so severely limited the meaning of "inadvertently" that the remedial purpose of that section of the statute is being thwarted. Moreover, in compliance with these requirements of the present law, enormous volumes of paper flow through the Patent and Trademark Office for the routine grant of supplemental licenses, often on redundant or trivial material.

A slightly modified system can fully meet national security purposes, while providing significant cost savings to users of the patent system and to the PTO.

The first proposed amendment in Section 2 of S.1535 embodies the concept that the filing abroad was "through error and without deceptive intent", which language appears (in a different context) in Section 251 of Title 35. The proposed change recognizes that it is difficult to argue persuasively that the act of sending written information overseas was "inadvertent" regardless of the intent. In the case of In re Wadlinger et al., 181 U.S.P.Q. 827, 832, the Court of Customs and Patent Appeals (now merged into the Court of Appeals for the Federal Circuit) noted that the primary definition of error or mistake is "to choose wrongly"; thus even if the filing without the requisite license were not strictly inadvertent but rather was due to an honest mistake in judgment, by this proposed amendment it could be rectified at the Commissioner's discretion.

Although the vast majority of patent applications do not contain subject matter involving national security, it is not proposed to change the law or procedure requiring that every patent application be reviewed. Part (2) of Section 2 proposes that, after the requisite license is obtained for filing a patent application abroad, the further submission aborad of supplemental material within the general scope of the original license would not require another license. This of course would apply only when the original license imposed no secrecy order.

This amendment is in harmony with proposed rules of the Patent and Trademark Office, which would grant a broad initial license that would encompass the further submission abroad of supplemental material. We believe this Amendment is needed to insure that those rules are put into practice.

Sections 3 and 4. - PENALTIES

35 U.S.C. §185 provides that failure to comply with §184 (discussed above) shall invalidate the patent, whatever the reason for or the consequences of the failure. Section 186 imposes a fine and prison term for violation of §181 and §184. The penalties for a non-deliberate and harmless failure to comply with §184 (as contrasted with violation of §181 relating to national security) are disproportionately harsh.

These amendments in Sections 3 and 4 provide that the failure to obtain the required license for subject matter which is not subject to a secrecy order under §181, if such failure was through error and without deceptive intent, would not make the patent applicant subject to a jail sentence or loss of the U.S. patent. The purpose is to enable discretion in the PTO and the courts to relate the penalty more closely to the infraction. Thus, only if the patent application or supplementary material involves national security would the penalties of patent invalidity, a fine, and imprisonment be applicable by statute. Other errors would not be fatal if made without deceptive intent.

Sections 5 and 6 - UNPUBLISHED RESEARCH AND JOINT INVENTION

These amendments to Section 103 will modernize the patent law by accommodating the realities of the inventive process as practiced in today's world. They are intended to improve and enhance scientific research by precluding in certain circumstances a research organization's own unpublished information from being used against it to defeat the rights to a patent when that information is not available to the general public.

In large research laboratories as well as in smaller technology-based businesses, there often exists scientific or technological prior knowledge in fields of ongoing inventive effort. This knowledge contributes to technological advances made in the laboratory. Team research, and the benefits of the free flow of information within a research organization, add inevitably to the intermingling of ideas from various people to achieve a desired result.

Under recent court interpretations of present law, an organization's own unpublished information which was developed by one individual on behalf of the organization can be used against the invention of another individual which was also developed on behalf of the organization at least insofar as the second individual is aware of the research of the first individual. (See In re Bass, 177 USPG 178 (CCPA 1973) and In re Clemens, 206 USPG 289 (CCPA 1980).)

The consequences of this growing body of law were analyzed in an article in the Journal of the Patent Office Society, October 1981, p. 516-559. A small portion of that article clearly summarizes the situation.

> "The impact of Bass and Clemens on the corporate research environment arises not from any Bass-Clemens rule per se, but rather from concepts of inventive entity and joint and sole inventorship under United States patent laws - laws that require each and every joint inventor to have contributed to the subject matter of each and every claim contained in a patent application ...

"Thus, in the corporate research environment where teamwork is the general rule and the general policy is to encourage knowing what fellow employees are doing, the patent laws place a premium on not knowing. What an applicant did not know when he made his invention cannot be used as prior art, but what he did know, can.

"Such encouragement of ignorance defeats a fundamental principle of corporate research - the free exchange of ideas between corporate employees. Moreover, it runs counter to both the policy and the spirit of the patent laws because it discourages both invention and the prompt disclosure of new inventions.

In view of the increasingly complex nature of the technological problems associated with research today, and the increasing cost of research, it is not sound public policy to penalize organizations which take a team approach to the solution of problems. By allowing this situation to continue as is is to add a further element of unreliability to the patent grant as a driving force for innovation. This situation is also counterproductive to the fundamental reason for the patent system because it discourages the disclosure of new technology through patenting.

The proposed amendment to 35 U.S.C. §103 would remedy this situation and accommodate modern research practices, by providing that unpublished prior information known to the patent applicant shall not defeat the patentability of a subsequent invention.

We note that overturning Bass and its progeny does not remove prior art as it is generally understood. It does, however, put the large research institutions on an equal footing with everyone else.

Since the time when S.1535 was introduced, many suggestions have been made for refinement of the language of the proposed amendment to Section 103. We support the version developed jointly by the American Intellectual Property Law Association and the Patent and Trademark Office which makes specific reference to prior art under Sections 102(f) and (g) of 35 U.S.C. (Exhibit C).

In re Bass and subsequent cases focused attention on the issues of joint invention in research organizations and in complex modern technology. The proposed amendment to 35 U.S.C. §116 expressly provides for the common occurrence that team research may lead to inventions that are not technically "joint" under present law. There is today a cloud on continuation-in-part applications where new researchers have joined the team, and on inventions which result from the collaboration of specialists who contribute different aspects of the inventive solution. This provision solves these problems by stating that "joint inventors" need not have contributed jointly to each individual claim in a patent application.

Here again, the AIPLA and PTO have proposed a refinement of the language of the proposed amendment to Section 116. We support their proposed language, also shown in Exhibit C. Also, they have proposed an amendment to Section 120 (also shown in Exhibit C) which would provide that a later filed patent application by an inventor or inventors of a previously filed pending application may claim the benefit of the filing date of that previously filed pending application, even though the later filed application does not name all of the same inventors as the previously filed application. We also support the amendment to Section 120 which we believe is necessary to accommodate the various inventorship situations which could arise under Section 116 as proposed for revision.

Sections 7, 8, 9 - PATENT INTERFERENCES

Patent interferences are extremely complex administrative proceedings whose purpose is to determine which of conflicting patent applicants is the first inventor in accordance with United States law. These amendments to 35 U.S.C. §135 are designed to simplify interference practice, to enable arbitration of priority of invention, and to remove an unnecessary pitfall for patentees.

Section 7

Since this proposal was made, the PTO has developed and adopted several improved internal procedures for expediting and simplifying the complex interference practice. We suggest that these procedures be given a fair test, and that the more rigorous proposal in Section 7 be set aside.

Section 8

Patent interferences are often settled privately, as with other litigation, to avoid protracted and expensive proceedings. 35 U.S.C. §135(c) requires that all such settlements be in writing and filed with the Patent and Trademark Office so that they can be made available to Government agencies, principally the Antitrust Division of the Department of Justice. There has been no recorded antitrust action, public or private, as a result of this filing statute. But based on the history of litigation in which the issue of compliance with this statute has been raised, its primary effect has been to provide another pitfall for patentees, due to uncertainty as to the scope of the statute and the harsh and inflexible statutory penalty which was originally suggested by the Department of Justice.

The purpose of the proposed amendments to Section 135(c) is to mitigate the penalty for inadvertent failure to meet the regulatory requirement and is similar, in purpose and in effect, to the amendment to 35 U.S.C. §185 in Section 3. Thus, it is proposed that the statutory penalty of loss of the patent shall not apply if any failure to comply was through error and without deceptive intent.

35 U.S.C. §135(d) at present grants limited discretion to the Commissioner to accept late filing of agreements. The proposed amendment would remove the six-month time limitation to the Commissioner's discretion, and thereby harmonize this provision with the discretion now granted in §184 for the late obtaining of licenses for foreign filing. The requirement for a showing of "good cause" to justify the tardy filing would remain in §135(c), and thus the degree of tardiness would still be a factor in the exercise of administrative discretion. The effect of these amendments is to remove another unnecessary pitfall for patentees, and to make the penalty for actions from which no harm has resulted subject to discretion, rather than to the absolute and disproportionate penalty of loss of the patent. We believe these revisions are in basic accord with the

desirable objective of preserving both the public interest and individual rights.

Section 9

This amendment adds a new subsection, 35 U.S.C. 135(d), which would enable the parties to an interference contest to arbitrate the question of priority of invention and other questions which are normally decided by the Patent and Trademark Office in rendering a decision on a contested patent interference.

This is a logical extension of the principle of arbitration of patent disputes. Enabling legislation for arbitration of issues of patent validity and infringement was passed in 1982 (35 U.S.C. 294). Arbitration of interferences will provide a much faster and far cheaper alternative to interference proceedings. Interferneces are proceedings which in many undesirable aspects resemble patent litigation, which is notoriously complex, tedious, time-consuming, and expensive. There appears to be no need to preserve this last exception to arbitration of patent-related disputes. Furthermore, passage of the revision to section 135(d) would be consistent with the public policy of providing a mechanism for dispute resolution which is faster and less costly than litigation, expressed by Congress when the arbitration clause (35 U.S.C. 294) was enacted.

Section 10 - LICENSE ESTOPPEL

Present law, following the Supreme Court decision in Lear, Inc. v. Adkins, 395 U.S. 653 (1969), is that a licensee cannot be estopped by contract or otherwise from attacking the validity of a licensed patent. This judge-made law would be codified in proposed 35 U.S.C. §295(a), but some of its later judicial "fall-out" would be eliminated.

Under the Lear doctrine, the contract rights of the licensor are largely illusory. A licensee is free to negotiate a contract to pay royalties to a patent owner. Thereafter, the licensee at any time can renege on the contract by either failing to pay the royalties or by bringing a declaratory judgment action on the ground that the patent is invalid. The licensor must then either bring a breach of contract action against the licensee or defend the patent in the declaratory judgment action.

Furthermore, there have been conflicting judicial interpretations of related issues, such as the right of the licensor to terminate the license, or to receive royalties if the licensee refuses to terminate the license while attacking the patent. At present, the discrepancies within and among the circuits are extreme, making it difficult for licensing parties to know their rights and obligations. The opportunities for mischief have become disproportionately high: a potential licensee can negotiate its best deal, sign the contract, and then move into court at its whim, secure in the knowledge that in some jurisdictions it is not even risking its license.

In any case, the licensee risks virtually nothing. If the patent is valid, courts are very likely to find that the agreed upon royalties are the best measure of the worth of the patent. Therefore, after prevailing in an expensive lawsuit, the licensor will receive only the royalties owed under the contract. Also, because the licensor remains bound to the contract, the license can continue to practice the invention after the patent is found valid.

The unfairness of the current state of the law is especially relevant when the licensor is an individual inventor and the licensee is a large corporation. That was the case in Lear.

A fairer balance is required between the integrity of contracts and the purported public interest in facilitating attacks on the validity of patents. Proposed 35 U.S.C. §295(b) embodies the principles that although a licensee is not estopped from contesting the validity of a licensed patent (codifying Lear) the licensee is liable for continuing royalties unless it terminates the license agreement. The licensee could not have his cake and eat it too. Further, the licensor would not be estopped from terminating the license during such contest. Until such termination by either licensor or licensee, royalties would continue to be paid to the licensor in accordance with the license agreement.

Section 11 - TRANSITION

We firmly believe that all the above changes in Title 35 will (1) help to increase the usefulness of the patent system as a national incentive to investment in innovation, and (2) bring greater predictability (and, therefore, reliability) to patents. For these reasons we urge that these changes be made applicable to the large number of unexpired United States patents. This transition section so provides.

EXHIBIT A

Rudolph J. Anderson
Merck & Company, Inc. (now with Monsanto Company)

Donald W. Banner
Banner, Birch, McKie & Beckett

Robert B. Benson
Allis-Chalmers Corporation

Homer O. Blair
Itek Corporation

Elvon H. Luther
Combustion Engineering Inc.

Harry F. Manbeck
General Electric Company

John E. Maurer
Monsanto Company

Dr. Pauline Newman
FMC Corporation

Jon S. Saxe
Hoffmann-LaRoche Inc.

Leroy G. Sinn
American Hoechst Corp.

Arthur R. Whale
Eli Lilly and Company

Richard C. Witte
The Procter & Gamble Company

EXHIBIT B

SUPPORTERS OF PATENT CODE REFORM BILLS

S. 1535 (MATHIAS) AND H. R. 4524 TO 29 (KASTENMEIER)

AIR PRODUCTS AND CHEMICALS, INC.
ALLENTOWN, PA

ALLIED CORPORATION
MORRISTOWN, NJ

ALLIS-CHALMERS CORPORATION
MILWAUKEE, WI

ALUMINUM COMPANY OF AMERICA
ALCOA CENTER, PA

AMERICAN HOECHST CORPORATION
SOMERVILLE, NJ

AMERICAN STANDARD INC.
NEW YORK, NY

AMERICAN TELEPHONE & TELEGRAPH CO.
NEW YORK, NY

ATLANTIC RICHFIELD COMPANY
PHILADELPHIA, PA

AVCO CORPORATION
GREENWICH, CT

BAXTER TRAVENOL LABORATORIES, INC.
DEERFIELD, IL

BECKMAN INSTRUMENTS, INC.
FULLERTON, CA

BELL LABORATORIES
MURRAY HILL, NJ

THE BLACK & DECKER MANUFACTURING CO.
TOWSON, MD

BORDEN, INC.
COLUMBUS, OH

BORG-WARNER CORPORATION
CHICAGO, IL

BRISTOL-MYERS COMPANY
NEW YORK, NY

BRUNSWICK CORPORATION
SKOKIE, IL

BURLINGTON INDUSTRIES
GREENSBORO, NC

CATERPILLAR TRACTOR CO.
PEORIA, IL

CHEVRON RESEARCH COMPANY
SAN FRANCISCO, CA

CIBA-GEIGY CORPORATION
ARDSLEY, NY

CLARK EQUIPMENT COMPANY
BUCHANAN, MI

CPC INTERNATIONAL INC.
ENGLEWOOD CLIFFS, NJ

COLORADO STATE UNIVERSITY RESEARCH FOUNDATION
FORT COLLINS, CO

COMBUSTION ENGINEERING, INC.
WINDSOR, CT

CORNING GLASS WORKS
CORNING, NY

DEERE & COMPANY
MOLINE, IL

DOW CHEMICAL COMPANY
MIDLAND, MI

DRESSER INDUSTRIES, INC.
DALLAS, TX

E. I. DU PONT DE NEMOURS & COMPANY
WILMINGTON, DE

EATON CORPORATION
CLEVELAND, OH

ETHYL CORPORATION
BATON ROUGE, LA

FMC CORPORATION
PHILADELPHIA, PA

GENERAL ELECTRIC COMPANY
FAIRFIELD, CT

GENERAL MILLS, INC.
MINNEAPOLIS, MN

GENERAL MOTORS CORPORATION
DETROIT, MI

THE GILLETTE COMPANY
BOSTON, MA

THE GOODYEAR TIRE & RUBBER COMPANY
AKRON, OH

HOBART CORPORATION
TROY, OH

INTERNATIONAL HARVESTER COMPANY
CHICAGO, IL

ITEK CORPORATION
LEXINGTON, MA

ELI LILLY & COMPANY
INDIANAPOLIS, IN

LITTON INDUSTRIES, INC.
BEVERLY HILLS, CA

MANVILLE CORPORATION
DENVER, CO

MERCK & COMPANY, INC.
RAHWAY, NJ

MILLIKEN & CO.
SPARTANBURG, SC

MINE SAFETY APPLIANCES
PITTSBURGH, PA

MINNESOTA MINING AND
MANUFACTURING COMPANY
ST. PAUL, MN

MONSANTO COMPANY
ST. LOUIS, MO

PENNWALT CORPORATION
PHILDELPHIA, PA

PFIZER, INC.
NEW YORK, NY

PRINCIPLE BUSINESS ENTERPRISES, INC.
DUNBRIDGE, OH

THE PROCTER & GAMBLE COMPANY
CINCINNATI, OH

PURDUE RESEARCH FOUNDATION
WEST LAFAYETTE, IN

SISA LABORATORIES, INC.
CAMBRIDGE, MA

SMITHKLINE BECKMAN CORPORATION
PHILADELPHIA, PA

SPERRY CORPORATION
GREAT NECK, NY

A. E. STALEY MANUFACTURING COMPANY
DECATUR, IL

STANDARD OIL COMPANY OF OHIO
CLEVELAND, OH

SUN COMPANY, INC.
RADNOR, PA

SYNTEX CORPORATION
PALO ALTO, CA

TENNESSEE TECHNOLOGY FOUNDATION
KNOXVILLE, TN

TUBE-ALLOY CORPORATION
HOUSTON, TX

UNION CARBIDE CORPORATION
DANBURY, CT

UNION OIL COMPANY OF CALIFORNIA
BREA, CA

UNIVERSITY PATENTS, INC.
NORWALK, CT

UOP, INC.
DES PLAINS, IL

USM CORPORATION
BEVERLY, MA

WESTINGHOUSE ELECTRIC CORPORATION
PITTSBURGH, PA

THE WISTAR INSTITUTE
PHILADELPHIA, PA.

EXHIBIT C

PROPOSED IMPLEMENTING LEGISLATION

Amend 35 USC §103 by adding at the end:

> In addition, subject matter developed by another, which qualifies as prior art only under Sections 102(f) or (g) of this title, shall not negative patentability under this section where the subject matter and the claimed invention were commonly owned at the time the invention was made.

Amend 35 USC §116 and §120 as follows:

Section 116

> When an invention is made by two or more persons jointly, they shall apply for patent jointly and each (shall sign the application and) make the required oath, except as otherwise provided in this title. Inventors may apply for a patent jointly even though (i) they did not physically work together or at the same time, (ii) each did not make the same type or amount of contribution, or (iii) each did not make a contribution to the subject matter of every claim of the patent.

Section 120

> An application for patent for an invention disclosed in the manner provided by the first paragraph of Section 112 of this title in an application previously filed in the United States, or as provided by Section 363 of this title, by an (the same) inventor or inventors named in the previously filed application shall have the same effect, as to such invention, as though filed on the date of the prior application, if filed before the patenting or abandonment of or termination of proceedings on the first application on or an application similarly entitled to the benefit of the filing date of the first application and if it contains or is amended to contain a specific reference to the earlier filed application.

Amend 35 USC §271 by adding the following new Sections:

> (e) Whoever without authority imports into or sells or uses within the United States a product made in another country by a process patented in the United States, during the term of the patent therefor, shall be liable as an infringer.
>
> (f) Whoever without authority supplies or causes to be supplied in the United States the material components of a patented invention, where such components are uncombined in whole or in part, intending that such components will be combined outside of the United States, and if such components were combined within the United States the combination would be an infringement of the patent, shall be liable as an infringer.

Senator MATHIAS. Thank you.

Mr. Witte, go ahead, sir.

STATEMENT OF RICHARD C. WITTE

Mr. WITTE. Thank you, Mr. Chairman.

Today, I am here to support this legislation for the Chemical Manufacturers Association and the National Association of Manufacturers.

These proposed changes are remedial in nature and are important to the principal users of the U.S. patent system which are the manufacturers and the universities who invest large sums in R&D and are important to employers of this country.

In the case of manufacture outside of the United States, either offshore production or final offshore assembly of exported components, U.S. patentees are presently helpless in view of the absence of statutory treatment.

Offshore production, using a process patented in the United States, puts the U.S. patentee at a disadvantage. Nearly every other country treats such offshore production as infringement. If we provide a similar law, the benefits to U.S. corporations will include, one, the incentive to invest in greater U.S. plant capacity since the patentee would have a patent-based advantage over foreign competition; Two, it would provide the generation of royalties which would be paid from foreign companies on products imported under license.

Of course, most U.S. companies patent their processes in foreign countries as well as the United States, but this is not an answer to the problem. U.S. companies should be entitled to use U.S. courts and to realize U.S. remedies for sale in the United States of products made by infringing their patented processes.

The offshore final assembly of exported components into a patented combination is a question of basic fairness. To permit the continued avoidance of infringement liability is to reduce the basic patent incentive on a mere technicality.

The slight change to the foreign filing licenses will protect U.S. patent owners from uncertainty in connection with a high technical problem. U.S. patent owners should be encouraged to file counterpart patent applications in foreign countries. Such filings would avoid dedication of important technology to foreign interests. It would also provide the basis for significant royalty payments back to the United States.

If foreign patent filing is unnecessarily complicated, this valuable development of overseas property could be unduly discouraged.

The team research problems resolved by sections 5 and 6 will provide greater certainty for U.S. manufacturers and universities in an area where high technical interpretation of the existing law has created problems which are incompatible with the team approach used in most modern research and development.

U.S. patentees do not wish to change the basic patent law on questions of novelty and on obviousness. They recognize that important patented industrial innovation may have to withstand attacks in these traditional areas.

It is unfair, however, to have patents invalidated on the highly technical points of inventor designation and the citation of secret technical work.

S. 1535 will provide procedural improvements in dealing with patent interferences. One will modify a highly technical problem in settling patent interferences. Another will permit arbitration of patent interferences. The former will encourage settlement of disputes which is a matter of judicial economy. The latter will improve the efficiency of the U.S. Patent Office.

The treatment of licensing agreements in section 10, the *Lear* v. *Adkins* section, should encourage the flow of technology by providing a more equitable treatment of patentees as well as licensees in disputes over patents.

It will also relieve the courts of dealing with some of the problems involved in patent license disputes.

Mr. Chairman, I appreciate the opportunity this morning of supporting S. 1535 on behalf of the CMA and the NAM.

[Statements submitted for the record follow:]

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE CHEMICAL MANUFACTURERS ASSOCIATION

PRESENTED BY RICHARD C. WITTE

My name is Richard C. Witte and I am Chief Patent Counsel of Procter and Gamble Company. I am chairman of the Task Force on Intellectual Property of the Committee on Innovation, Technology and Science Policy of the National Association of Manufacturers. I am also chairman of the Patent and Trademark Committee of the Chemical Manufacturers Association.

The National Association of Manufacturers is a voluntary business association of over 13,000 corporations, large and small, located in every state. Members range in size from the very large to over 9,000 smaller manufacturing firms, each with an employee base of less than 500. NAM member companies employ 85 percent of all workers in manufacturing and produce over 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

Chemical Manufacturers Association is a nonprofit trade association whose member companies represent more than 90% of the productive capacity for basic industrial chemicals in the United States.

We commend the Subcommittee for holding these hearings and thank the chairman and his staff for affording NAM and CMA the opportunity to express their views on the merits of the Effective Patent Laws Bill, S. 1535.

NAM and CMA are pleased to support S. 1535. We believe that enactment of this legislation will strengthen the U.S. patent laws and provide needed certainty to protect the large investments of time and money which go into product innovation.

A strong, effective U.S. patent system is needed to strengthen the technological base of this nation, to encourage research and invention and the commercial development of new technology, to stimulate investment by the private sector in technological progress, to improve the international trade balance of the United States, to increase employment, and to provide a wider selection of products and services for consumers.

Changes in patent law that can contribute to U.S. industrial competitiveness are increasingly needed. The recent interim recommendations from the President's Commission on Industrial Competitiveness makes clear that "streamlining patent laws and procedures to encourage more R&D and commercial development of new technology" is essential.

The pace of technological growth is slowing in the United States. We believe that the patent system has the potential to serve as a more forceful element in encouraging technological commitment and investment in innovation. We believe that it is not only feasible to increase the effectiveness of the patent system for this purpose, but it is essential.

The urgency of our national situation with respect to technological leadership and innovation has convinced us that modification of the patent law, in ways that strenghthen the incentive role of patents, can have a significant effect in encouraging investment in innovative efforts.

The National Association of Manufacturers and the Chemical Manufacturers Association want patent laws which are fair and which provide a measure of certainty in order to protect the huge investments of money and staffing which go into product innovation. They want to improve the way in which the patent system works. These proposed improvements are not basic changes in the patent system, but are necessary to improve fairness and certainty.

The capability of the small, technology-based entrepreneurial company to generate advanced processes is a most important part of private sector initiatives. They must be protected against the pirating of their processes. Their resources are usually stretched so that legal battles to protect their processes can divert and drain their very existence.

Following are the specific comments of NAM and CMA on the provisions of S. 1535:

Section 1 of S. 1535 addresses an important gap in existing U.S. patent laws. Under current U.S. law, patentees are helpless in cases involving infringement when manufacture has been outside the United States, either by offshore production of imported products made by a patented process or by final offshore assembly of exported components into a patented combination. Off-shore production using a process patented in the United States, puts the United States patentee at a disadvantage. Nearly every other country treats off-shore production as infringement where an imported product is made by a process patented in that country. United States law should provide similar protection.

Of course, most U.S. companies patent their processes in foreign countries as well as the U.S., but this is not an answer to the problem. U.S. companies should be entitled to use U.S. courts and realize U.S. remedies for sale in the U.S. of products made abroad by infringing their patented processes. The offshore final assembly of exported components into a patented combination is a question of basic fairness. To permit continued avoidance of infringement liability is to reduce the basic patent incentive on a mere technicality.

Section 1 of S. 1535 addresses this issue. This provision will benefit U.S. industry, particularly the U.S. chemical industry, by increasing the incentive to invest in greater U.S. plant capacity and the generation of royalties paid from foreign companies on products imported under license.

The slight change to the foreign filing licenses will in no way affect national security. It will, however, protect U.S. patent owners from uncertainty regarding their patent applications on a highly technical problem which will be resolved by Sections 2, 3, and 4 of S. 1535. U.S. patent owners should be encouraged to file counterpart patent applications in foreign countries. Such filings avoid the dedication of important technology to foreign interests and provide the basis for significant royalty payments back to the U.S. If foreign filing is complicated with unnecessary technicalities which could adversely affect the enforceabilty of the U.S. patent, then this valuable foreign filing of patent applications could be unduly discouraged. The team research problems resolved by Sections 5 and 6 will provide greater certainty for U.S. manufacturers in an area where a highly technical interpretation of the existing law has created incompatibilities with the team approach used in most modern research and development, in both universities and corporations.

U.S. patentees do not wish to change the basic patent law on questions of novelty, utility, and nonobviousness. They recognize that important patented industrial innovation may have to withstand attacks on these traditional areas of scrutiny. They are willing to deal with such attacks on substantive merits. It is unfair, however, to have patents invalidated on highly technical points such as:

(a) Did every named inventor make an inventive contribution to every claim in the patent?

(b) Has every bit of private secret work by every person who worked on a corporate or university team which created an important invention been considered in filing the patent application?

Section 8 and Section 9 of S. 1535 will provide procedural improvements in dealing with patent interferences that will, respectively, remove a highly technical problem in settling patent interferences and will permit arbitration of patent interferences. The former will support the basic policy of encouragement settlement of disputes, a matter of judicial economoy. The latter will provide a reasonable means to improve the efficiency of the Patent and Trademark Office in handling interferences.

Section 10 of S. 1535, dealing with licensing agreements, also contains a beneficial change to existing patent law. This provision should encourage the flow of technology by providing a more equitable treatment of patentees, as well as licensees in disputes over patents. It will also relieve the courts of dealing with some of the problems involved in patent license disputes.

In summary, S. 1535 represents important improvements in a basically sound patent system. NAM and CMA believe that the provisions of S. 1535 will improve the certainty, fairness and efficiency provided by the system to its principal users, manufacturers engaging in research and development, who are also the principal employers in the United States. We, therefore, are pleased to support this legislation.

ADDITIONAL STATEMENT OF RICHARD C. WITTE IN SUPPORT OF S. 1535

I appreciate the opportunity to support this legislation. I am Richard C. Witte, Chief Patent Counsel for The Procter & Gamble Company. I am Chairman of the Patent and Trademark Committee for the Chemical Manufacturers Association and Chairman of the Task Force on Intellectual Property of the National Association of Manufacturers. These two organizations, as well as my own Company, support this proposed legislation.

The national interest in the patent system is based on its contributions in strengthening the technological base of the nation, in encouraging research and invention and the commercial development of new technology, in stimulating investment by the private sector in technological progress, in improving the international trade balance of the nation, in increasing employment, and in providing a wider selection of products and services.

The pace of technological growth is slowing in the United States. We believe that the patent system has the potential to serve as a more forceful element in encouraging technological commitment and investment. We believe that it is feasible to increase the effectiveness of the patent system for this purpose.

The urgency of our national situation with respect to technological leadership and innovation has convinced us that modification of the patent law, in ways that strengthen the incentive role of patents, can have a significant beneficial effect in encouraging investment in innovative efforts.

The several parts of this bill have been well summarized in the remarks introducing this legislation. These proposed changes are remedial in nature but represent improvements which are important to the principal users of the U.S. patent system, the manufacturers who engage in research and development and are the principal employers of this country.

The National Association of Manufacturers and the Chemical Manufacturers Association want patent laws which are fair and which provide a measure of certainty in order to protect the huge investments of money and staffing which go into product innovation. They want to improve the way in which the patent system works. These proposed improvements are not basic changes in the patent system, but are necessary to improve fairness and certainty.

In connection with several of the proposed changes, a problem resulting from a court decision is being resolved. These court decisions were well-meaning. They dealt properly with the law as it then existed but, for a variety of reasons, created some unfairness and uncertainty in a basically good system.

In the case of manufacture outside the U.S., either off-shore production of imported products made by a patented process or final offshore assembly of exported components into a patented combination, patentees are helpless in view of the absence of statutory treatment of this important infringement issue. Section 1 of S.1535 will resolve these problems.

Off-shore production using a process patented in the U.S. puts the U.S. patentee at a disadvantage. Nearly every other country treats off-shore production as infringement where an imported product is made by a process patented in that country. If U.S. provides a similar law, the benefits to U.S. corporations will include:

(a) The incentive to invest in greater U.S. plant capacity. (The patentee will now have a patent-based advantage over foreign competition.)

(b) The generation of royalties paid from foreign companies on products imported under license.

This change is particularly important to the chemical industry.

Of course, most U.S. companies patent their processes in foreign countries as well as the U.S., but this is not an answer to the problem. U.S. companies should be entitled to use U.S. courts and realize U.S. remedies for sale in the U.S. of products made abroad by infringing their patented processes.

The off-shore final assembly of exported components into a patented combination is a question of basic fairness. To permit continued avoidance of infringement liability is to reduce the basic patent incentive on a mere technicality.

The slight change to the foreign filing licenses will in no way affect national security. It will, however, protect U.S. patent owners from uncertainty regarding their patent applications on a highly technical problem which will be resolved by Section 2, 3, and 4 of S.1535. U.S. patent owners should be encouraged to file counterpart patent applications in foreign countries. Such filings avoid the dedication of important technology to foreign interests and provide the basis for significant royalty payments back to the U.S. If foreign filing is complicated with unnecessary technicalities which could adversely affect the enforceability of the U.S. patent, then this valuable foreign filing of patent applications could be unduly discouraged.

The team research problems resolved by Sections 5 and 6 will provide greater certainty for U.S. manufacturers in an area where a highly technical interpretation of the existing law has created problems which are incompatible with the team approach used in most modern research and development. This applies to both universities and corporations.

U.S. patentees do not wish to change the basic patent law on questions of novelty, utility, and nonobviousness. They recognize that important patented industrial innovation may have to withstand attacks on these traditional areas of scrutiny. They are willing to deal with such attacks on substantive merits. It is unfair, however, to have patents invalidated on highly technical points such as:

(1) Did every named inventor make a inventive contribution to every claim in the patent?

(2) Has every bit of private secret work by every person who worked on a corporate or university team which created an important invention been considered in filing the patent application?

Section 8 and Section 9 of S.1535 will provide procedural improvements in dealing with patent interferences that will, respectively, remove a highly technical problem in settling interferences and will permit arbitration of patent interferences. The former will support the basic policy of encouraging settlement of disputes, a matter of judicial economy. The latter will provide a reasonable means to improve the efficiency of the Patent and Trademark Office in handling interferences.

The licensing agreements treatment in Section 10 should encourage the flow of technology by providing a more equitable treatment of patentees as well as licensees in disputes over patents. It will also relieve the courts of dealing with some of the problems involved in patent license disputes.

In summary, S.1535 represents important improvements in a basically good patent system in order to improve certainty, fairness, and efficiency.

Summary of Richard C. Witte's Support of S.1535

The National Association of Manufacturers and the Chemical Manufacturers Association want patent laws which are fair and which provide a measure of certainty in order to protect the huge investments in product innovation. The proposed charges of S.1535 will help this certainty.

Off-shore production using a process patented in the U.S. presently puts the U.S. patentee at a disadvantage. If U.S. changes its law, the benefits to U.S.

corporations will include: (a) The incentive to invest in greater U.S. plant capacity. (The patentee will now have a patent-based advantage over foreign competition.) (b) The generation of royalties paid from foreign companies on products imported under license.

The off-shore final assembly of exported components into a patented combination is a question of basic fairness. To permit continued avoidance of infringement liability is to reduce the basic patent incentive on a mere technicality.

The slight change to the foreign filing licenses will in no way affect national security. It will, however, protect U.S. patent owners from uncertainty regarding their patent applications on a highly technical problem. U.S. patent owners should be encouraged to file counterpart foreign patent applications. Such filings avoid the dedication of technology to foreign interests and provide the basis for royalty payments back to the U.S.

U.S. patentees do not wish to change the basic patent law on questions of novelty, utility, and nonobviousness. They recognize that important patented industrial innovation may have to withstand attacks on these traditional areas of scrutiny. It is unfair, however, to have patents invalidated on highly technical points such as: (1) Did every named inventor make a contribution to every claim in the patent? (2) Has every bit of private secret work by every person who worked on a corporate or university team been considered in filing the patent application?

Procedural improvements in patent interferences will remove a technical problem in settling interferences and will permit arbitration. These will encourage settlement of disputes, judicial economy, and will provide a reasonable means to improve the efficiency of the Patent and Trademark Office.

The licensing agreements treatment should encourage the flow of technology by providing a more equitable treatment of patentees as well as licensees in disputes over patents. It will also relieve the courts of dealing with some of the problems involved in patent license disputes.

Senator MATHIAS. Mr. Schlicher.

STATEMENT OF JOHN W. SCHLICHER

Mr. SCHLICHER. Mr. Chairman, thank you for the opportunity to testify before you on these important bills. I support both S. 1535 and S. 1841. I support the concepts behind most of the provisions of S. 1535, except section 7, although I believe that many of the provisions could be improved.

Senator MATHIAS. That is why we are here.

Mr. SCHLICHER. However, I believe that titles III and IV of S. 1841 constitute the most economically significant and perhaps controversial aspects of the bills. I have addressed my testimony to those sections. I believe that S. 1841, if enacted, would increase the incentives for innovation without any loss in competition from activities properly prohibited by the antitrust laws.

This bill does not involve a tradeoff of the benefits of free competition associated with antitrust principles to achieve the benefits of invention and innovation associated with patent and copyright laws. The bill involves a situation George Shultz described in his book as a trade-on, a change in law or policy which permits one to achieve more in one area without giving up anything in another.

The possibility of a trade-on arises because the patent, copyright, and antitrust laws have a common purpose, to provide certain different conditions for the country's scarce resources to be used in the most productive way. Because those laws are designed to solve different problems, applying antitrust law to licensing patents and copyrights does not require a choice which sacrifices some of the benefits of one set of laws to achieve the benefits of the other.

The opportunity for Congress to make this trade-on arises because the courts have improperly defined the relationship between those two bodies of law. With one exception, Congress has never spoken on the relationship between the patent and copyright laws and the antitrust and misuse laws. During the congressional silence, the courts have consistently narrowed the means by which patent and copyrights may be profitably exploited. The Supreme Court did not create those rules based on experience. The law developed from judicial theory. For example, the Supreme Court finds misuse based on licensing a patent on the condition that the licensee buy unpatented supplies, because all such agreements are deemed to provide a limited monopoly outside the scope of a patent. They are illegal without any consideration of whether the patent owner was attempting to achieve, had achieved or had any prospect of achieving market power in the market for supplies and without considering whether the agreements provide any procompetitive benefits, such as increasing the percentage of the value of the invention paid to the patent owner, increasing use of the invention and reducing transaction costs of licensing. Those purposes are not anticompetitive. They are procompetitive. There are no reported cases I am aware of that show that anyone has ever acquired a monopoly outside the scope of a patent or copyright by this device.

The courts conclusively presumed certain types of agreements to be economically harmful without any consideration of this potential for actually economic harm, their economic benefits or any balancing of benefits against harm. In doing so, those rules serve neither the purpose of the patent and copyright laws nor the purpose of the antitrust laws.

The current laws affect virtually every license agreement involving technology developed or used in the United States. By correcting that error, the bill will increase incentives for innovation without resource allocation loses from decreased competition.

The current law makes licensing less profitable than use by the owner in making and selling products because the patent owner as producer may lawfully do many of the things contributing to efficient use of the invention which a licensing patent owner may not compel his licensee to do under the misuse rules. Hence innovators which are not fully integrated companies with capacity to produce and sell products, such as research companies, startup companies and individual inventors are at competitive disadvantage to fully integrated companies. Such persons and companies have less incentive to innovate than established manufacturing companies. In addition, many of the rules that apply to patents do not apply to trade secrets or to leasing personal property. Hence these rules create undesirable incentives to avoid the patent system and to avoid patent licensing in favor of licensing and leasing other things, even though that would be less profitable in the absence of these rules. Both of those consequences ultimately reduce incentives to innovate and reduce long-run competition.

This bill simply directs the courts to evaluate restrictions on technology use based on consideration of their potential for actual economic harm, their possible economic benefits, and, if necessary, a balancing of those benefits against harms in the market setting of the agreement. In addition, it compels the courts to apply the same considerations in ruling on patent misuse as it does in ruling with respect to antitrust violations.

It should, in my view, be enacted. Thank you.

[The following statement was received for the record.]

PREPARED STATEMENT OF JOHN W. SCHLICHER

The Economic Problem Underlying Patent and Copyright Laws

The Constitution recognizes that, in the absence of patent and copyright laws, there will be too little progress in science and useful technology.[1] Inventions and writings are intangible information, not physical goods. There are two problems which, if unremedied, will cause too few resources will be allocated to the production of information. The problem of externalities exists whenever the production of a good provides benefits to persons other than those with whom the producer has some pre-production agreement to be paid for those benefits. This is appropriately called the "free-rider" problem. Indivisibilities exist when the nature of a product requires that, in order to satisfy the demand of one user or consumer, the producer must make one unit of the product which is also capable of satisfying the demands of many other users or consumers. Such products are sometimes referred to as "public goods".

In the absence of patent and copyright laws, the market for information will exhibit external benefits and indivisibilities. Use of technical information in making goods may require disclosure to users and, hence, some users may have access to it and benefit from it without being required to pay. The same is true for the writings of authors. The cost of producing inventions and works are also all fixed costs. Once produced, intangible knowledge or information can be transmitted and used or reproduced without any additional resources being expended. The average cost of production for all uses always exceeds the marginal cost of use, which may be zero. Once produced, no single price for all uses can both ration the existing supply of information (a price equal to marginal cost) and provide adequate incentives for producers to make them (a price at least equal to average cost). Rather than inventors and authors being natural monopolists, they are natural failures.

Free, unrestricted competition in use of inventions and works will not yield proper resource allocation. The patent and copyright laws are designed to solve these economic problems by granting to the producers of an invention the temporary rights to exclude others from making, using or selling products embodying it[2] and to producers of works of authorship the temporary rights to exclude others from reproducing or distributing copies of the work.[3] Those rights permit their owner to prevent external benefits and charge a price for use greater than marginal cost. Patent and copyright laws merely give to the producers of intangible information the right to exclude, which property law gives to the owner of physical property. A patent or copyright does not necessarily permit its owner to obtain an economic monopoly of any product. Products using a patented or copyrighted invention or work must compete with all products using past inventions or works. The value of any particular patent or copyright will depend upon the value of the invention or writing it protects in view of all alternative inventions and writings available. That value will be determined by the market for inventions and works in which the rights to exclude are used or transferred by sale or license to others.

The Economic Problem Underlying the Antitrust Laws

Antitrust laws are necessary to provide some different conditions for markets properly to allocate resources. Agreements between actual or potential competitors to limit their competition will prevent markets from achieving this goal. The function of markets depends upon competition among suppliers of products in that market. Elimination of that competition by agreements having no offsetting benefits cause too few resources to be allocated to those markets. The antitrust laws also seek to prevent firms from improperly acquiring or maintaining monopoly power in a market. Unjustified monopolies also interfere with resource allocation by causing too few resources to be allocated to the markets in which those monopolies exist.

Patent And Copyright Laws Do Not Conflict With The Purpose Of Antitrust Law

The granting of patents and copyrights does not result in the resource allocation losses which are caused by unjustified monopolies and anti-competitive agreements. Patents are granted only for processes and products which are new and nonobvious in the sense that they differ technically from those which were used or known before the invention.[4] A patent or copyright does not preclude use of any pre-existing technology.

Assume that an old product is produced under perfectly competitive conditions. Because of the possibility of patenting, a new product is invented and patented, which is superior to the old product. Since the new product is subject to a patent, its seller may exclude competition from using it. For some users of the old product, the new product is more valuable to them, even if priced based upon maximizing by a single seller. Those old product users switch to new product. Competitors may continue to sell the old product, but will sell less. No resource allocation loss is involved because the consumers who switch are better off or they would not have done so and those who do not switch are no worse off. The portion of the demand for the new product not supplied, because of lack of competition due to the patent, is not a resource allocation loss, as in the case of an unjustified monopoly or an anti-competitive agreements. The new product did not exist and could not have been supplied without the invention. It is necessary to incur that "loss" to induce the invention of the new product, which improved the welfare of the consumers. Indeed, competition has increased. Without the patent, and the invention it prompted, there would be no new product market to be concerned about. Resource allocation has been improved.

The patent grant and its "monopoly" of use of the invention is consistent with the purposes of the antitrust laws. Antitrust laws do not require that all inventions be freely available for use by all competitors. The country is not better off by creating rules which take away the incentives to create new products. The benefits from new products and processes are enormous. Agreements which maximize the patent owner's returns from use of the invention yield an important long run, pro-competitive benefit.

Two possible costs of patents and copyrights are not economically necessary. The first is that patent licenses may provide a cover for horizontal agreements between actual or potential competitors not to compete in products made without using the patent Such agreements give rise to limits on competition unrelated to vertical exploitation of the invention. S. 1841 will not affect the law with respect to such horizontal agreements. The second is that, in theory, patent owners may make vertical agreements with users of the patented invention which permit the patent owner to acquire a monopoly not granted by the patent and exploit that monopoly to restrict output in markets for products made independently of the patent.

S. 1841 Provides An Economically Sound Test For Judging The Legality Of License Agreements

This second possibility is the basis for virtually all the patent misuse and antitrust law to which the bill relates. The Courts have determined that certain agreements always have this result and are always misuse or antitrust violations. The bill would change that law by requiring that, before reaching such a conclusion, the Courts consider the actual effects of such provisions in the market in which the agreements were made. That standard would require the Court consider both any anti-competitive potential and any pro-competitive benefits from the restriction. Moreover, it would provide that the standard for determining legality for antitrust purposes is the same standard that is used to determine patent misuse.

The relationship between a patent owner and its licensees is a vertical relationship. The patent owner is the supplier of an invention, one of many resources needed by the licensees to produce a product. Restrictions in vertical agreements may benefit competition. Restrictions on licensees may permit the patent owner to charge for its use based upon the different values of the invention to different users or in different uses. They may be devices to compel efficient use by the licensee. They may be devices to give licensees incentives to make investments, which permit more efficient use of the invention. Such restrictions may increase use of an invention. Restrictions serving those functions benefit competition by increasing the returns to the patent owner from use of the invention, and increasing the incentive to make inventions. The bill would require that those benefits be balanced against any anti-competitive restraints not necessarily resulting from granting the patent, before finding an antitrust violation or patent misuse.

The Current Law Makes Exploitation Of A Patent Or Copyright By Licensing Less Profitable Than Use In The Owner's Business To Make And Sell Products

The antitrust and patent misuse doctrines have operated primarily by prohibiting patent owners from exploiting their inventions by permitting others to make and sell the patented products. Such agreements are vital. Such agreements are necessary to permit the invention to be used in the most efficient way. License agreements are merely transactions by which the supplier of one necessary product provides it to another at a price which leaves both parties better off and the country better off by permitting resources to be used by those, who have the most valuable use for them. Because misuse law prohibits certain provisions of vertical license agreements, which compel the licensee to engage in certain conduct which is entirely lawful if done by the patent owner, the law makes use by a patent owner more profitable than use by licensing. This places innovative individuals and companies which can not exploit their inventions by producing and selling products at a distinct competitive disadvantage to those that can.

Some Of The Current Patent Misuse, And, In Some Cases, Antitrust Prohibitions Which Would And Should Be Tested By The Standard Of S. 1841

The Relation Of The Royalty Base To The Patent

In 1969, the Supreme Court held that a license agreement constituted patent misuse, where the patent owner conditioned the grant of the license upon payment of royalties on products which do not use the teachings of the patent.[5] The Court said such provisions were devices by which a patent owner could obtain a monopoly on the unpatented products, which monopoly could then be exploited injuring resource allocation in the market for the unpatented product. Assume the highest royalty rate for a license, where royalties are based only on patented products. If the patent owner requests a royalty base, which includes both patented new and unpatented old products, the licensee will not agree to pay royalties for both at that rate. That would require payments greater than what the patent is worth. At a lower royalty based on all products, the quantity of unpatented old products sold by licensees may decrease due to the royalty. If there are other unlicensed suppliers of the unpatented old product, this device is unlikely to restrict total output of the unpatented product. Output of the patented new product under this arrangement will increase due to the lower royalty. It can not be said that the effect of the agreement is harmful, because any losses in output of the unpatented old product may be offset by increase in quantity of the patented product. The likelihood of a patent owner acquiring market power over the market that includes both patented and unpatented products depends upon the market share of the licensees for the patented and unpatented products and the ease of entry into sale of the unpatented product. At prices above the level cost plus the lower royalty rate, the agreement has no effect on competition in sales of the unpatented product.

Moreover, this device may have the effect of improving increasing use of the new product by reducing transaction costs. The value of a patent is incapable of exact determination. The scope of a patent is frequently unclear and changes over time and differs from country to country. The costs of keeping records and making reports on products defined by patent claims may be significant. One method of reducing those costs is to make the royalty base independent of the scope of the patent. In that way, the parties can predict with greater certainty in advance the extent of the royalty obligations involved and reduce the administrative costs of the agreement. The Court seems to recognize that this royalty base serves those legitimate functions, although it is only legally operative in situations in which the history of negotiations shows that the licensee recognizes and, presumably, shares in that benefit by not asking for a limited base.

This rule has not been applied to licensing other intellectual property. There is no rule that requires that licensors of trade secrets collect royalties based only on use of those trade secrets. Accordingly, this rigid patent law rule creates undesirable incentives for licensors of technology to license secret know-how or lease personal property rather than license patents, since they may then agree to a royalty base which reduces uncertainties and costs.

I am confident that it is virtually never a patent owner's purpose to achieve a monopoly on an unpatented product by requiring licensees to pay royalties on it. If that were profitable, the way to put licensees at the maximum competitive disadvantage with respect to unpatented products is to charge a zero royalty on sales of the patented product and the maximum negotiable rate for the unpatented product. That is not what the agreement before the Supreme Court in 1969 provided and I am aware of no reported case which remotely suggests it has ever been done. Rather, the purpose of such a rate base is to reduce transaction costs.

The Relation Of Royalty Payments To The Patent Term

Prior to 1964, there was no limit on the term for royalty payments under a patent license. In 1964, the Supreme Court, with Justice Harlan dissenting, held that, when a patentee sold a patented hop picking machine and granted a license to use the machine, which called for royalties based on use before and after expiration of the last patent "incorporated into the machine," the patentee can not enforce the license to the extent that it called for post-expiration royalties.[6] While most lower Courts have recognized that this decision did not find the patent was unenforceable for patent misuse, a few Courts have found that post-expiration royalties constitute misuse.[7] The Court refused to enforce that part of the agreement because it was a device by which the patent owner could extend his monopoly to encompass the time after expiration and exploit that monopoly to limit production.

The value of the patent to the licensee is limited by the differences between the cost and demand during the patent's term. After the term, all others will be able to use the invention freely in competition with those licensees and the license provides them with no additional benefits. Hence, in order for the licensee to agree to pay over the longer term, the rate must be lower. Under that lower rate, output during the term will expand and output after the term may or may not decrease. The agreement does not prevent other companies from entering or companies selling unpatented competitive products from continuing to sell in the post-expiration period. The use of the long royalty term does not permit the patent owner to collect royalties equal to that he could obtain if the term of the patent were, for example, twenty-five years. The market power arising from the invention can only be exploited once. Even if competition is limited and output is restricted in the post-expiration period, there is an offsetting benefit in that competition has been greater and output has been greater during the patent term.

The lengthened term may also have benefits which increase use of the invention. Spreading those royalties over a longer period of time is a device by which the patent owner assists in financing the cost of his licensees adopting the new product.

A company which may itself produce and sell both the patented new and unpatented old products may charge for them any price above cost he desires. If he reduces the price of the patented new product to a price below the maximum he could charge during the patent term and tries to increase it in the post-expiration period, he may do so. A company which must exploit the patent by licensing may not, and the same undesirable results follow. The result of the decision is to treat manufacturing patent owners more favorably than non-manufacturing patent owners. Again, if it were really profitable to forego royalties during the term to obtain a monopoly after the term, the way to do that is to load all royalties into the post-expiration period. That is not what the patent owner who was before the Supreme Court in 1964 was doing and there is no reported case of such agreement.

"Discriminatory" Royalties

In the 1960's, the lower Courts found that a Gulf Coast shrimp canning company, which owned shrimp peeling patents, violated the antitrust laws and misused the patents by licensing West Coast shrimp canners, in effect, at a higher per pound royalty rate than it charged Gulf Coast canners.[8] Shortly thereafter, one Court reasoned that the refusal to license is the ultimate in discrimination and found that a refusal to license for personal rather than business reasons constituted misuse.[9]

The ability to license each user based upon the value of the patent to that user always permits the patent owner to earn higher revenue and in many instances will lead to greater use of the invention than a single royalty rate. The hop picking machine patent owner did it by licensing each user based upon the amount of hops picked. The Supreme Court in 1964 did not note any impropriety in that even though farmers who produced more hops pay a higher royalty per machine than farmers who produced fewer hops. Patent owners commonly and lawfully license different licensees in different fields for the precise purpose of charging royalties proportional to the different values of the invention in its different uses. The legality of those restrictions have been unanimously upheld.[10]

A policy which would seek to eliminate charging royalties proportionate to the value of the invention to different licensees would dramatically limit the value of patents to patent owners and the use of patented inventions. The prohibition against royalty discrimination somehow assumes that there is some resource allocation loss, whenever competing licensees are charged different royalty rates. In fact, it is never in the patent owner's interest to charge identically situated licensees different rates in order to eliminate the competition between them. If that were a patent owner's goal, it would be achieved far more efficiently by declining to license the disfavored licensee, as is its right.

Tying Arrangements And The Creation Of The Misuse Doctrine

Early in this century, the owner of a patent on mimeograph machines sold machines under a license with the restriction that it may be used only with paper and ink made by the patent owner. In 1912, the Supreme Court held that the sale of ink suitable for use in the machine in certain circumstances was contributory infringement and would be enjoined.[11] In 1917, the Supreme Court reversed itself in the

Motion Picture Patents.[12] It held that, where a patent owner licensed another who made and sold motion picture projectors having a patented film feeding part and put a notice on the projector that the purchase gives only the right to use it with unpatented films leased from the patent owner, the restriction was unenforceable. That decision was extended in 1938, when the Court held that an agreement in a license of a patented process that the licensee purchase an unpatented material for use in the process is unenforceable.[13]

In 1942, the Court held that agreements of this type rendered a patent entirely unenforceable, even against a direct infringer.[14] In that case, Morton Salt, a patent owner leased a patented salt dispensing machine to canners under a license to use it only with the patent owner's salt tablets. In an action against a maker of infringing machines, the Court held that the patent was unenforceable, even though the infringer, as a machine seller, was not harmed by the misuse and even though there was no evidence establishing any injury to competition sufficient to establish a violation of the antitrust laws. At about the same time, similar developments were taking place in antitrust cases.[15]

These rules arise out of the Court's conclusion that such agreements have the purpose and effect of giving the patent owner a monopoly beyond the scope the patent granted and, therefore, undesirably restrict competition in unpatented products. The fact that such agreements require a licensee to buy some unpatented product does not necessarily mean that competition in that product is restricted or, that if it is, there are not pro-competitive benefits which justify the restriction. The Court in Morton Salt found the patent totally unenforceable, whether or not competition in the salt market was actually suppressed. There was absolutely no discussion as to whether the Morton Salt Company acquired or was even attempting to acquire any salt monopoly (even a "limited monopoly"), that the amount of salt sold was restricted or that the price of salt increased by virtue of this agreement. The agreement to buy salt may simply have had the purpose of permitting the patent owner to collect, in the least costly way, royalties from different users of the invention proportional to the different values of the invention to them.

The potential benefits for resource allocations of tying arrangements can be illustrated considering variations of the facts in the first of these cases, Motion Picture Patents, involving projectors and films. The patent owner could make the new projectors, set up its own theaters, make its own films for showing in those theaters, and go into the theater business. That would raise no grounds for any antitrust violation or misuse defense, even though he would be obtaining some share of the market for films. The patent owner might elect to make and sell projectors. A single price for projectors may not maximize profits. The value of the improved projector to each user may be different. The patent owner might sell the projectors and individually negotiate licenses with each customer with a royalty based on the value and intensity of use of each licensee. To the extent that the value of the projector depends merely on the number of times it is used, the patent owner might attach a meter to the projector, and sell or lease it at a price dependent upon the metered use. Neither of those alternatives would raise antitrust or misuse problems. However, the costs of doing so may render those possibilities unprofitable.

The patent owner might seek to accomplish the same goals by selling the projectors with a license to use them only with films from the patent owner. The patent owner would make or buy films at market prices and supply them at above market prices. Theaters which use more films or use them more frequently, and therefore use the projector more intensively, would, in effect, be paying a higher royalty rate. His ability to charge a higher price for films does not reflect any market power in the general market for films. It reflects only the fact that a patent owner has not charged as high a price as he could have for projectors and rather collects its royalty based on film supplies. Depending on circumstances of the film market, the patent owner may or may not have by this device obtained any market power in the film market. Moreover, to the extent that it does, the benefit from increased returns for use of the invention and increased use of the invention during the term of the patent may justify any restriction on supply of films.

There are other reasons why projector patent owners might wish to supply films having nothing to do with acquiring a film monopoly. If films are supplied by a non-competitive market, the patent owner may wish to reduce the price of films, increasing the demand for projectors and the value of the invention. Another purpose, other than acquiring a film monopoly, is to encourage the licensee to use both projectors and film in the most efficient proportions. Another possible reason is to assure the quality that the films supplied are technically compatible with the projector. In addition, owners of process patents and combination patents are frequently in a position of being unable to directly exploit the invention. They may sell a product used in a patented method or combination to reduce the transaction costs of licensing users individually, while achieving some of the benefits of charging licensees based on the intensity of the use of the method or combination. Reducing those transaction costs benefits the patent owner and the country.

The adverse impact of the Morton Salt test on the value of patents is demonstrated in its companion case, B.B. Chemical Co..[16] There, the patent owner sought to prove that, unless it was permitted to exploit its patent by granting implied licenses to purchasers of a product used with the patented process, there was no other feasible way for it to obtain any income from the use of its invention. The Supreme Court said that the impossibility of exploiting the patent in any other manner was "without significance."

Another important consequence of the Morton Salt decision was that it made clear that no antitrust violation had to be established in order to establish patent misuse. The Court did not say what the lesser standard was, except that tying agreements always constitute misuse. That decision spawned the current body of law which flatly prohibits types of agreements without any evidence of their effects in the market and without any evidence of any pro-competitive benefits from them. There is no basis for applying those separate standards. In practice, the misuse doctrine, with its lesser standard, prevents use of any agreement which meets that misuse standard. No patent owner will enter an agreement, which renders the patent unenforceable against infringement. The bill would require that a single standard be applied.

Licensing More Than One Patent Or Copyright In A Single Agreement

In the late 1940's, the Court stated that a copyright or patent owner which refused to license its copyrights or patents other than as a package violated the Sherman Act.[17] The Courts have frequently found that a patent owner who conditions the grant of a license under one patent on the licensee's acceptance of a license under other patents had misused the patents.[18]

The law with respect to tying arrangements does not compel this result. The alleged harm of tying arrangements, namely, that patent owners acquire a monopoly over products not within the scope of the patent, is obviously inapplicable. The patent owner already has a monopoly in the supply of licenses under the other patents. A tying arrangement can give him no further market power with respect to their supply. There are reasons a patent owner or copyright owner would seek to license as a package other than to restrict competition. Where patents relate to the same use, it is impossible to negotiate a separate royalty on a patent by patent basis, because the royalty for any one patent depends upon the royalty for another. In addition, different licensees may place different values on the separate patents. By placing a single value on the package, the patent owner achieves to some degree the ability to charge different licensees at rates which reflect those different values. Such a license may reduce negotiation and enforcement costs. No licensee will pay more than the patents as a group are worth to him, and no licensee will use inventions, which are not profitable to use.

Those practices may or may not increase the use of the inventions or the copyrighted works. However, it is certain that this device does not extend the scope of any patent or copyright. Rather, it is a profit-maximizing device. The bill would require rule of reason analysis of such agreements.

Restrictions Against The Licensee Dealing In Competitive Products

In the 1940's, two Courts found that a license agreement in which the licensee agrees to refrain from dealing in competitive products constituted patent misuse, whether or not the agreement was likely to have any adverse effects on competition.[19] The Courts gave the same reason for creating that rigid rule. Such restrictions extend the patent monopoly to unpatented products.

Such agreements may have resource allocation benefits. A licensee's agreement not to deal in competitive products may avoid the free rider problem which arises when the licensee's investment has external benefits for products sold in competition with the patented product. The restriction may induce the licensees to invest greater amounts of money in further development and marketing of the patented product. Such investments will increase the output of the patented product by avoiding undesirable externalities in such investments, increasing competition from patented product suppliers. This is the same benefit which arises from granting exclusive licenses, which has always been found lawful. If the patent owner insists upon its licensees agreeing not to sell a competitive product, they will agree only if the royalty rate is reduced to compensate them for the losses to them from not marketing that product. The reduced royalty rate, which will be charged to induce the licensees to forego those, presumably, more profitably alternative products, will lead to increased output of and competition from the patented product.

The effects of the limitation on competition in the unpatented competitive product are unclear. The limitation on competition between the patented product and the unpatented product will depend upon what percent of the former suppliers of the unpatented products became licensees. If fewer than all such suppliers are licensed, competition between the licensees and the remaining sellers of the unpatented product may not be diminished.

The Court's assumption that such an agreement is always the method by which the patent owner acquires a broader monopoly, which it can exploit, is simply wrong. The unnecessary prohibition of such agreements again make exploitation of the patent by making and selling products more profitable than exploiting the same invention by licensing.

Field Of Use Restrictions On Process Patents

Historically, the Courts in approving field of use restrictions have not distinguished between restrictions on the sale of a patented product from those on sale of unpatented products made by patented processes. However, in one recent case, the owner of a patent on a process for making an old but very valuable chemical catalyst granted to one United States licensee an exclusive license to make and sell the unpatented catalyst using the process and granted licenses to other companies limited to making and using such catalysts in their own manufacturing operations. After one Court failed to find that these agreements constituted patent misuse,[20] another Court held that they violated the Sherman Act.[21] A Court of Appeals reversed that finding, but on the narrow grounds that the purported exclusive license to sell the unpatented catalyst made by the patented process was lawful, where the process was the only economically viable one.[22] Whether or not such a restriction would constitute patent misuse is a matter of some question.[23]

FOOTNOTES

1. U.S. Constitution, Article I, Section 8.
2. 35 U.S.C. § 154, 271 (1976).
3. 17 U.S.C. § 106 (1976).

4. 35 U.S.C. §§ 102 and 103 (1976).

5. *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969).

6. *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

7. *E.g.*, *cf.* *Rocform Corp. v. Acitelli-Standard Concrete Wall, Inc.*, 367 F.2d 678 (6th Cir. 1966).

8. *LaPeyre v. FTC*, 366 F.2d 117 (5th Cir. 1966), *aff'g in part & setting aside in part sub nom.* *Grand Caillou Packing Co. Inc.*, Trade Reg. Rep. (CCH), FTC Complaints & Orders § 16,927 (FTC 1964); *Peelers Co. v. Wendt*, 260 F. Supp. 193 (W.D. Wash. 1966); *Laitram Corp. v. King Crab, Inc.*, 244 F. Supp. 9, *modified*, 245 F. Supp. 1019 (D. Alaska 1965).

9. *Allied Research Prods., Inc. v. Heatbath Corp.*, 300 F. Supp. 656, 657 (N.D. Ill. 1969).

10. *E.g.*, *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1938), *aff'd on rehearing*, 305 U.S. 124 (1938).

11. *Henry v. A.B. Dick Co.*, 224 U.S. 1, 25-36 (1912).

12. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 518 (1917).

13. *Leitch Mfg. Co. v. Barber Co.*, 302 U.S. 458, 460-463 (1938).

14. *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942).

15. *International Business Machines Corp. v. United States*, 298 U.S. 131 (1936); *International Salt Co. v. United States*, 332 U.S. 392 (1947).

16. *B.B. Chem. Corp. v. Ellis*, 314 U.S. 495, 496-497 (1942).

17. *United States v. Paramount Pictures*, 334 U.S. 131, 156-59 (1948).

18. *Hazeltine Research, Inc. v. Zenith Radio Corp.*, 388 F.2d 25, 33-35 (7th Cir. 1967), *rev'd in part on other grounds*, 395 U.S. 100 (1969).

19. *McCullough v. Kammerer Corp.*, 166 F.2d 759 (9th Cir.), *cert. denied*, 335 U.S. 813 (1948) (misuse); *National Lockwaster Co. v. George K. Garrett Co.*, 137 F.2d 255 (3rd Cir. 1943) (misuse).

20. *Ethyl Corp. v. Hercules Power Co.*, 232 F. Supp. 453 (D. Del. 1964).

21. *United States v. Studiengesellschaft Kohle, M.B.H.*, 426 F. Supp. 143 (D. D.C. 1976).

22. *United States v. Studiengesellschaft Kohle, M.B.H.*, 670 F.2d 1122 (D.C. Cir. 1981).

23. *cf.* *Robintech, Inc. v. Chemidus Wavin, Ltd.*, 628 F.2d 142, 146-49 (D.C. Cir. 1980).

Senator **Mathias**. You have commented in your statement to some extent on the question that I asked Mr. Banner at the outset, whether or not the slowdown in the growth of technology in the United States or at least the relative slowdown as compared with what is happening in the rest of the world is in some measure related to flaws in the patent system, and you would think that that is true I gather from what you just said.

I wonder, Mr. Witte, Mr. Maurer, do you agree?

Mr. **Witte**. Yes, sir, I agree. I also think that these changes are necessary to turn it around, to speed up innovation, and turn their problem around.

Mr. **Maurer**. Certainly we would agree with that. I think that what we are trying to do here is, as I said, adapt the system to today's climate of business and to improve the reliability of the system because of its importance to research-oriented companies.

Senator **Mathias**. Now, as we have discussed in the course of the morning, some of these proposals have been around for awhile, and the reason that they have not been adopted into law is that somebody was less than enthusiastic about them.

One of the fears may be, and Mr. Schlicher again touched on this in his statement, that they will reduce competition in some way, that they will adversely affect the interest of the consumer.

Could you comment on that?

Mr. **Maurer**. I believe he was addressing his comments to S. 1841, is that correct, Mr. Schlicher?

Mr. **Schlicher**. That is correct.

Mr. **Maurer**. Not to S. 1535, which I do not believe would have that effect.

Senator **Mathias**. Well, I wanted to ask you very directly because you represent a major manufacturing company what you thought the effect of this on the consumer would be, because I think the record should reflect that at some point.

Mr. **Maurer**. Well, I think looking at it on a long term basis, I guess I happen to believe, and I do not know that I should speak for all members of the Ad Hoc Committee on that point, but I believe that, to the extent that we can insure that the patent system performs the function that it is intended to perform and, therefore, increase ultimately the productive capacity of the United States that the consumer will benefit in the long run from those improvements.

Senator **Mathias**. In other words, if there is a continued decline in innovation, the consumer will suffer.

Mr. **Maurer**. Ultimately, yes. I believe that very firmly. And I think we look at it from the standpoint also of our role in the competitive world that we live in. To the extent that we cannot be sure that the United States remains competitive, the consumer will suffer in the long run because of the competition from foreign countries and people in foreign countries, the jobs that we would lose as a result of that.

Senator **Mathias**. What answer would you give if objection is made to these bills that the patent system is already sufficiently generous to industry and that industry has ill rewarded that generosity by moving considerable production offshore in the search for cheaper labor or less onerous regulation? I'm sure we will hear that argument?

Mr. **Schlicher**. Senator, if I may make one comment first. When one looks back to the Scott amendments, which were the only previous legislative proposal to deal with the problem that S. 1841 deals with, and that was controversial, I think you will find that those amendments did not contain provisions even remotely comparable to titles III and IV. With respect to the question of whether U.S. industries are somehow obligated to produce in the United States because we have a good patent system, when, in fact, it may be more profitable for them to produce offshore because of cheaper labor rates and tax rates—a primary reason lots of that is done—I think it is a point which goes, perhaps, to changing policies which keep labor rates higher, and keep taxes higher, keep safety and health regulations costly, another reason for going overseas.

Senator **Mathias**. Those are not strictly patent considerations.

Mr. **Schlicher**. That is correct.

Senator **Mathias**. But then there is no rule of germaneness in debating in the U.S. Senate.

Mr. **Schlicher**. I think it is not the purpose of the patent laws to provide all of the conditions for companies to be able to produce efficiently and competitively in the world markets. It is related to one specific economic problem that free market economies have, and it attempts to address that problem.

Mr. **Maurer**. I think as far as S. 1535 is concerned, obviously many of the amendments are more remedial in a sense to improve, but let us take a look at the process patent one. It seems to me that that has the effect that I believe we should be looking for, and that is to encourage manufacture in the United States by, in effect, not allowing competition to exist using U.S. technology in an offshore location.

I think that is exactly one of the reasons why the process amendment is important, that it will promote industry in the United States.

Senator **Mathias**. And will reduce the incentives for going offshore.

Mr. **Maurer**. Absolutely.

Mr. **Witte**. Not only that, Mr. Chairman, I think, in addition to that, the other parts of this remedial legislation will attempt to strengthen and retain technology in this country, whether it is the foreign filing licensing or the secret prior use or even *Lear* v. *Adkins*, that which strengthens the patent system will tend to keep the technology at home and can increase it.

Senator **Mathias**. Now, both of your companies must do a considerable international business. How is this going to play in the international markets? Will you feel strengthened by this in terms of foreign operations, generally in your international representation?

Mr. **Witte**. For my own company, we do business abroad competing with one another, but the benefit comes back to the home company, the royalties, the increased worldwide business, the export of materials.

Senator **Mathias**. And your international operations, you think, will be strengthened?

Mr. **Witte**. Oh, yes, but the strength of the home company will be increased also.

Mr. **Maurer**. I would support what Mr. Witte says. I think that to the extent that it has an effect on our international operations, my first judgment is, it is a little indefinite. I think the point is that it will strengthen the U.S. operation, and that is where the emphasis ought to be.

To the extent that there may be some fallout in terms of the international area, I think that is a very secondary consideration. What we are trying to do is strengthen the parent company, which is the U.S. company.

Senator **Mathias**. I suppose I should be more specific. Would you anticipate any retaliatory steps by any of the trading nations with which your company trades?

Mr. **Maurer**. At first blush I would say no because, for example, you take the process amendments. That is the kind of law that exists in the major manufacturing countries throughout the world. We are the exception, not the rule, so that that situation already exists in terms of our competing in other countries.

So we are only becoming equal, I think, from that standpoint. That is certainly one which will have more effect from an international standpoint than I believe the other ones.

The other thing I had not mentioned is you take the *Lear* v. *Adkins* decision. The concept of licensees being able to attack validity was a proposition that first grew out of the U.S. law and has been, to a certain extent, adopted by other countries to maybe not the same degree but it has certainly crept into Europe.

Hopefully we might be able to temper that situation from getting worse from the international standpoint.

Mr. **Schlicher**. Mr. Chairman, I would second the notion. It seems abundantly clear to me that in passing S. 1841 and S. 1535 there would not be a remote possibility of any retaliation by any other Western European or Japanese country, mainly because, as was pointed out with respect to the process infringement question, those countries already have those laws. With respect to misuse laws and the *Lear* v. *Adkins* doctrine, our major trading partners to this date do not have laws as restrictive of their domestic industries as our laws are of our industries. Indeed, the European Economic Community has been struggling for over 10 years to try to write a code which incorporates American misuse law and they have now done it. If Congress were to indicate that the sense of policy in the United States was that there should be revisions in that area, I think it is almost certain they would follow us, and I think with respect to the *Lear* v. *Adkins* question that a similar result would be expected.

Senator **Mathias**. Thank you very much, gentlemen.

Our final witness for today is Mr. Alfred B. Engelberg, chief patent counsel of the Generic Pharmaceutical Industry Association.

STATEMENT OF ALFRED B. ENGELBERG, CHIEF PATENT COUNSEL, GENERIC PHARMACEUTICAL INDUSTRY ASSOCIATION, WASHINGTON, DC, ACCOMPANIED BY JAMES F. FLUG, WASHINGTON COUNSEL, GENERIC PHARMACEUTICAL INDUSTRY ASSOCIATION

Mr. ENGELBERG. Mr. Chairman, my name is Alfred Engelberg. I am with the law firm of Amster, Rothstein & Engelberg in New York, and I am here on behalf of Generic Pharmaceutical Industry Association.

Senator MATHIAS. I see you are accompanied by a familiar figure.

Mr. ENGELBERG. I am accompanied by Mr. James F. Flug, of the law firm of Lobel, Norrins & Lamont, who represents the Generic Pharmaceutical Association here in Washington.

Senator MATHIAS. Mr. Flug is a welcome visitor to the committee on all occasions.

Mr. ENGELBERG. First, let me say I appreciate the opportunity to tell you why at least one of these proposals has been around for a long time and has never been enacted, and that particularly is the offshore process infringement bill.

I would also like to say one other thing in view of the chairman's remarks opening this hearing, and that is that the Generic Pharmaceutical Industry Association very strongly believes in and benefits from the incentives provided by the patent system, and, in fact, were it not for those incentives, the generic industry might not exist.

The question in all of these laws and where we seem to be on the other side of the question from some of our illustrious colleagues in the patent bar is on the issue of what laws stimulate invention and what laws stifle competition.

Turning to the process bill, we have, in this country, a law called the Tariff Act, specifically section 337 of the Tariff Act, designed to protect domestic industries against injury from importations.

U.S.C., title 19, sec. 1337(a) of that statute specifically provides a remedy in those instances where the practice of a patented U.S. process offshore causes injury to a domestic industry. Mr. Witte talked about the incentives to U.S. manufacturers. Those incentives already exist. In fact, with respect to any domestic U.S. operation, you can go into the Tariff Commission and get the relief that is sought by the process patent bill.

I might add that patentees are flocking to the Tariff Commission in record numbers these days because of statutory provisions that require that a decision be made within a year and because of the high respect for patents and high number of patents held valid in that forum.

One very key provision of the process patent bill as compared to the Tariff Act is to eliminate the requirement that there be a domestic industry. In fact, it may be the main difference between the two provisions. If the legislation is enacted, you will be able to enforce a U.S. process patent even if you do not practice that U.S. process in the United States. In the Tariff Commission proceedings there is no chance that you can enforce that patent.

Mr. Banner makes the point that we have a great number of foreign owners of domestic patents these days. In fact, I believe Commissioner Mossinghoff has mentioned in some of his speeches numbers in the 30- to 35-percent range.

Many of those patents are, of course, process patents owned by multi-national companies, companies in Japan, Germany, England. Those companies do not practice those processes in the United States, but this bill would give them the right to enforce patents that they practice themselves offshore to prevent competition, to prevent situations where U.S. companies involved in subassembly manufacturing operations, for example, may wish to purchase a part in some other country for competitive reasons.

It has also been mentioned here this morning that this law would put us in step with every country in the world. It really is not so in at least two very important respects. One is that most of the industrialized nations of the world have working requirements in their patent laws.

They recognize that there is a relationship between patent law and commerce in the country, and they, therefore, say that if you do not actually exploit the patent within the territory within a period of 2 to 3 years from the time the patent is issued, you cannot enforce the patent. In fact, in England, they go further and say even if you are exploiting the patent, if you are not exploiting it efficiently and making product available at reasonable prices, there will be compulsory licensing so that there will be an assurance that products will get to consumers at reasonable prices.

We have no working requirement in this bill or in this country. We have no compulsory licensing. So the net effect is while we have a Tariff Act that would protect domestic industries where they need protection, what is being proposed here is that we open up the system so that process patents can be enforced even when the processes are not practiced here.

I submit that that is probably the primary reason why this bill has never been enacted. It is simply not needed and it does not do anything for domestic production.

I might mention another inequity and inconsistency with foreign patent law that seems to me has been completely overlooked by my colleagues and is built into the current patent law. Particularly, sections 102(a) and 102(b) and section 104 discriminate against foreign inventors in the sense that our law says that while a prior public use and sale in this country more than a year before the invention is made is a bar to a patent, will render a patent invalid, a prior use and sale in a foreign country is not.

Similarly under section 104, you cannot rely on acts abroad to prove priority of invention. The Supreme Court many years ago in a very wise decision, which has become an axiom of patent law, said that that which infringes if later in time anticipates if earlier, and we have before the Congress a bill which, in effect, would prohibit a foreign manufacturer from coming into a courtroom in the United States and saying:

> I have been practicing this process for many years abroad, many years before you got your U.S. patent. I cannot be an infringer. Your invention has no novelty with respect to what I have done.

And if you put the proposal together with existing law, we end up with a ruling that says, "We do not care whether your invention is novel or not, Mr. Foreigner, because you cannot rely on the acts that you have engaged in to defend against this charge of infringement."

It makes no sense. It is a demonstration that the patent law is very complex, and it is difficult to treat one piece of it without treating the other pieces at the same time. I think that has been overlooked.

Finally, and I think this was referred to briefly by Mr. Pravel on behalf of the American Intellectual Property Association. He talked about the unfairness of an importer being charged with infringement when he may not know about the patent.

I think the problem runs even deeper than that. In the typical buy-sell situation, the buyer is purchasing a product, the component that he may use to put together on an assembly line here. He does not know how that product is made. In fact, his supplier does not want to tell him how it was made because that trade secret in how the product was made may be the supplier's only advantage. It may be the only reason the supplier has the business because he controls some trade secret technology.

We are in a situation where if we attempt to enforce process patents in this situation, we are going to be asking domestic importers to take responsibility for discovery of facts which are not in their possession, namely, what the process is in the foreign country, and we are going to be assuming that if the foreign manufacturer does not come in and disclose his process that he must be guilty of the infringement. It seems to me that that cannot possibly be true. There is an awful lot of distrust for protective orders. There are an awful lot of reasons why someone would not disclose or want to disclose a trade secret or a process. Whether or not foreigners come in and disclose that information is going to depend on how much business they do here, how big the buyer is, how big the patent owner is, and a lot of competitive issues that have nothing to do with whether a patent is valid or infringed.

The victim of all that is going to be the small businessman, the small importer who needs the widget to use in his factory and to run an assembly line.

I submit, Mr. Chairman, that the Tariff Act really takes care of all these problems in a very sensible way, and what it says, quite simply, is if you have a process and you are using that process in the United States and someone is injuring you by offshore production, come and see us. We will give you relief. If that is not true, there is no reason to hinder competition by adding this type of legislation to the existing patent law.

Thank you.

Senator MATHIAS. You mention the British experience and the state of the law in Britain. Why do you suppose it is that as you visit American college campuses or American laboratories that you find so many people with a British accent?

I mean, the brain drain is a very real thing. Does the state of the law in Britain have anything to do with the brain drain?

Mr. ENGELBERG. It may be the state of a lot of things. I do not know that one can attribute that to the state of the patent law. I mean, they have a fine, functioning patent system. I think many parts of our own patent system are derived from that.

My only point in referring to British patent law—it is not just British patent law. It is German patent law and Dutch patent law and Japanese patent law. All include some form of a working requirement.

It is a recognition that patent portfolios can be built to block the wheels of commerce and innovation, and often are, as much as they stimulate innovation. There is an awful lot of what we call defensive patenting.

I think there have been proposals, very valid ones, by the Patent Office to make that easier, to get those kinds of patents and those publications that would not be enforced but would protect people.

There are many attempts by companies to patent or to get patents on things that they do not use, and I think the recognition simply is that in those instances where the result of a research effort is created and produces new products and those new products stimulate an economy, the patent laws work and they are enforced. Where the patent is not worked in the country, then the reasons for enforcing that patent, at least to the same extent, are not there.

Perhaps licensing is appropriate in that situation. Perhaps no enforcement is appropriate. Perhaps there are other public interest factors. My comment, Senator, is simply that the statement made here—that we are out of step with the rest of the world and that we are going to make a minor change in our patent law that is going to make us the same as everyone else—is simply not the fact.

We do not have that working requirement. We have a very anti-compulsory licensing attitude toward patents in this country. If we want to reexamine that, fine, but I think we should reexamine it in the context of the total system and not just one change.

Senator **Mathias**. I would like to go back to your comment that you see some of the provisions of this bill as possibly encouraging offshore operations.

Mr. **Engelberg**. I refer strictly to the process patent bill. I have no problem with the attempt to overcome the Supreme Court decision in *Deepsouth*. I think it raises entirely different questions.

With respect to the encouragement of offshore process production, I simply point out that those companies that practice processes in the United States presently have a remedy and that remedy is in the Tariff Commission and within less than 3 months on a temporary exclusion order, within a year on a mandatory basis in any other kind of case if there is a patent and it causes injury to a domestic industry. That term is defined, I might add, by the Tariff Commission in very liberal terms. Any conceivable lost sales that flow out of this infringement of a process is enough to exclude products made by the process. This is the ultimate enforcement of a process patent—the giving back of exclusivity.

The reason that I say that this bill encourages offshore production is that these large companies are obviously involved in a global competition. If they are practicing those process patents here, they do not need the bill. They can go to the Tariff Commission tomorrow.

So my point is that one of the main arguments and reasons for the bill, although it has not been stated, is that it will free those companies to practice the process anywhere in the world and still enforce their process patents in the United States. The bill is not necessary.

Senator **Mathias**. I think I have no further questions. Thank you very much.

Mr. **Engelberg**. Thank you, Mr. Chairman.

[The following material was received for the record:]

PREPARED STATEMENT OF ALFRED B. ENGELBERG

My name is Alfred Engelberg, and I am Patent Counsel to the Generic Pharmaceutical Industry Association and a partner in the firm of Amster, Rothstein & Engelberg of New York City. I have been engaged in the practice of patent law for over twenty years and during that time period, have been a Patent Examiner in the United States Patent and Trademark Office, a patent attorney for a large multi-national corporation, a patent trial attorney for the United States Department of Justice, and a private practitioner.

As you know, there is already an existing law which protects domestic manufacturers from foreign imports made by infringing processes abroad. Under 19 U.S.C. 1337(a), the ITC can exclude imported products which infringe a patent, but only if "the effect or tendency...is to destroy or substantially injure an industry efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and commerce in the United States...".

In my opinion, the Tariff Act provisions strike the appropriate balance by protecting patent owners from foreign infringement only if they are actually engaged in the domestic exploitation of a process patent. If, in fact, the primary purpose of the legislation is to protect domestic jobs and industries, then there is no reason for a broader-based process patent infringement bill. It must be borne in mind that a substantial percentage of all U.S. patents are now granted to foreign applicants. Certainly, permitting foreign (or multi-national) patent owners to enforce U.S. process patents in order to protect foreign manufacturing activities will not create domestic jobs unless those process patents are actually being exploited in the United States. Indeed, it would be somewhat anomalous for Congress to give foreign patent owners greater protection at a time when it is considering "domestic content" legislation which would limit foreign imports by requiring products such as automobiles to be made from parts manufactured in the U.S.

Many of the proponents of this legislation have argued that U.S. Patent Law is out of step with the rest of the world in refusing to enforce process patents more broadly. This, in fact, is not the case. The patent laws of most countries, such as England, Germany, Holland, Japan and the rest of the industrialized world, require that a patent be "worked" by actual use of the patented invention in that country. Compulsory licensing may be ordered if a patent is not "worked." Indeed, in England, for example, compulsory licensing may be ordered even in those instances where the patent is being "worked" but production is insufficient to make products available at reasonable prices. There are also other public interest situations where compulsory licensing may be invoked--patents covering drugs is one such area. In the final analysis, these economic overrides on the operation of the patent system are comparable to the fundamental purpose underlying the Tariff Act. It is for that reason that Congress has consistently rejected earlier attempts to enact this type of legislation.*

The pending ITC proceeding involving the prescription drug known as indomethacin demonstrates why the Tariff Act provides adequate protection. For 17 years, Merck owned a product patent covering this anti-arthritic drug and properly reaped hundreds of millions of dollars in monopoly profits. The product patent has now expired and generic drug companies are preparing to import indomethacin. Merck has now purchased a U.S. process patent issued to a Japanese chemical company and is seeking to prevent importation of indomethacin based on that newly acquired patent. In the ITC, the case can be defended on the ground that there is no injury to Merck and a substantial benefit to the public. No such defense is available under the proposed legislation. Given the substantial monopoly which Merck has already enjoyed, there is no reason to eliminate the defenses which are provided in an ITC proceeding.

It has also been argued that proceedings before the

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*A formal memorandum prepared by GPIA which deals with the Tariff Act, as well as previous attempts to enact similar process patent infringement legislation is annexed to this statement as an Appendix.

Tariff Commission are cumbersome. There is, in fact, no real evidence to support that assertion. To the contrary, the use of ITC proceedings to enforce patents against foreign infringers is very much in vogue. This is due to the vigorously enforced statutory time limits which assure patent owners of a speedy result. The real reason why Merck and others seek the present legislation is to avoid the legitimate economic defenses which can be asserted in ITC proceedings.

Wholly apart from the foregoing, in the typical buy/sell situation, the buyer may neither know nor care about the process actually used by its supplier to produce the product being sold. Indeed, suppliers ordinarily maintain process information as a trade secret since manufacturing methods are the lifeblood of many businesses. Many suppliers are very reluctant to disclose any process details to their customers for fear that they will eventually lose their competitive edge (and their customers) as a result of such disclosure. Given these fairly typical facts, it makes no sense to put the burden of proving non-infringement of a patent on the innocent importer of products. Yet, by charging the importer with infringement of a process patent, the burden of proving non-infringement may fall on the importer. Indeed, the Commissioner of Patents supports a proposal before the House of Representatives (H.R. 3577) which would formally shift the burden of proof to the importer. That proposal is based on the erroneous belief that the importer's leverage as a customer of the accused infringer can be used to force the accused infringer to disclose the details of the accused process. In practice, it is not likely to work in that manner. Rather, the accused infringer's decision to defend patent infringement litigation may well be based on other factors such as the amount of business involved; the value of the trade secrets involved; the identity of the patentee; and the nature of the worldwide competition between the patentee and the accused infringer. Innocent buyers may well lose access to valuable sources of supply, even though there is no actual infringement, simply because a foreign manufacturer legitimately refuses to make a disclosure of trade secrets to a competitor.

Those who would argue that any disclosure problems can be solved by the use of protective orders in litigation are simply not being realistic. Protective orders are largely distrusted by the business community, and no one believes that they completely prevent the flow of valuable information to clients who are directly involved in a litigation. Important bits of confidential information can "slip out" all too often despite the good faith efforts of counsel. Clearly, the best protective order is non-disclosure.

The expansion of the definition of process patent infringement is also clearly inequitable given other provisions of the patent law relating to activities in foreign countries. For example, under 35 U.S.C. §104, a foreign applicant may not rely on any activities in a foreign country for the purpose of establishing priority of invention. Similarly, under 35 U.S.C. §102(a) and (b), the prior use or sale of an invention in a foreign country cannot be relied upon as prior art for the purpose of establishing patent invalidity. These statutory provisions have their roots in the long held belief that the development and verification of evidence relating to foreign activities is too difficult and such evidence is inherently unreliable. Logic would appear to dictate that precisely the same evidentiary barriers exist with respect to proving infringement. In any event, if the expanded process infringement legislation is enacted without changing other parts of the patent law, it would be possible to find a foreign manufacturer guilty of infringement even though that manufacturer was the first inventor of the patented subject matter, or had been engaged in the actual use of the patented subject matter for many years prior to the issuance of the U.S. patent. The inequity in such a result is self-evident. Moreover, that inconsistency demonstrates the difficulty in attempting to make important substantive modifications to the patent law on a piecemeal basis or on the basis of alleged parity with the patent laws of other countries. In that regard, it should be noted that many of the countries which enforce process patents where production occurs in a foreign country also permit reliance on prior public use or sale in a foreign country to establish patent invalidity.

In summary, our present law already provides for the enforcement of process patents against imported products and strikes an appropriate balance between the enforcement of patent rights and the protection of domestic industries. Unless and until a body of economic information is developed which would establish that a braoder enforcement of U.S.. patent rights would be beneficial to U.S. industries and U.S. jobs, there is no reason to go any further.

SUMMARY OF STATEMENT OF ALFRED B. ENGELBERG RE S1535

We are opposed to the proposed amendment to Section 271 of Title 35 which would extend patent infringement liability to the practice of patented processes in foreign countries for the following reasons:

1. The provisions of the Tariff Act (19 U.S.C. 1337) provide adequate protection for U.S. manufacturers in those instances where the infringement of a patented process causes injury to a domestic industry.

2. A substantial number of U.S. patents are owned by foreign applicants who do not practice the patented inventions in this country. The proposed law would actually provide greater protection to these patent owners than the laws in any other industrial nation. Most other countries require that the patent owner actually "work" the patent in that country as a pre-condition of injunctive relief. Otherwise, a patent may be subject to compulsory licensing. These provisions are similar in spirit to the provisions of the Tariff Act.

3. Process information is normally retained as a trade secret by its owner and is the lifeblood of many businesses. A U.S. importer charged with infringement will normally have no knowledge of the process used to make a product and no means of gaining access to that knowledge. Foreign manufacturers may refuse to defend infringement cases, rather than risk disclosure of trade secrets unless substantial amounts of business are involved even though meritorious defenses exist. Thus, domestic businesses (and jobs) could be needlessly put at risk.

4. The Patent Law deprives foreign inventors of the right to prove prior invention or invalidity of a patented invention based upon prior use or sale in a foreign country. If foreign acts can form the basis for a charge of infringement, it must logically follow that foreign activities should be available to prove invalidity or prior invention.

MEMORANDUM IN OPPOSITION TO EXTRATERRITORIAL EXPANSION OF THE PATENT LAW BY BARRING IMPORTS OF ITEMS MADE LAWFULLY ABROAD & COVERED BY U.S. PROCESS PATENTS

Introduction

This memorandum is respectfully submitted in opposition to enactment of legislation originally proposed by an Ad Hoc Committee of Multinational Chemical and Industrial Manufacturers, and subsequently proposed by the Cabinet, 25 Pat. Trademark & Copyright J. No. 623, at 461 (Mar. 31, 1983); see also H.R. 3577, 98th Cong., 1st Sess., Cong. Rec. H5196 (daily ed. July 14, 1983).

The proposed legislation would bar United States importers from importing goods made in any country by a process currently patented in the United States, except where authorized. The practical effect of this legislation is to place the burden of ascertaining production methods on the importer, who naturally will hesitate to import unless he is able to get full production process information. The exporter may often be reluctant to furnish such information for fear of revealing trade secrets.

The proposed legislation would be counterproductive and harmful because:

I. The existing Tariff Act already provides sufficient protection for patent holders.

II. Virtually all countries that bar importation of goods made through patented processes have active use requirements and compulsory licenses. To grant such additional protection in the United States, which has no compulsory license provision or use requirements, risks the creation of greatly expanded monopolistic power.

III. Moves to restrict imports have been defeated before because no need for them has been demonstrated. Further, such restrictions are particularly counterproductive in oligopalistic industries where existing problems will be aggravated.

IV. The proposed legislation would have a potentially devastating effect on the generic drug industry and ultimately, consumers.

Background

This drastic change to the patent law has been proposed many times before only to be routinely defeated in Congress.

The bill which was recently introduced in the House of Representatives, H.R. 3577 98th Cong. 1st Sess., Cong. Rec. H5196 (daily ed. July 14, 1983) would amend section 271 of Title 35.

The bill provides:

> If the patented invention is a process, whoever without authority uses or sells in the United States during the term of the patent therefor a product produced by such process infringes the patent.

* * *

> **In actions alleging infringement of a process patent based on use or sale of a product produced by the patented process, if the court finds (1) that a substantial likelihood exists that the product was produced by the patented process and (2) that the claimant has exhausted all reasonably available means through discovery or otherwise to determine the process actually used in the production of the product and was unable so to determine, the product shall be presumed to have been so produced, and the burden of establishng that the product was not produced by the process shall be on the party asserting that it was not so produced.**

The proposed bill creates problems for the importation of products made by patented processes for several reasons. The bill makes no distinction between exporting countries which grant protection to United States patent holders and those countries which do not. Furthermore, the bill creates a presumption that the product was made by a patented process without the patentee having to prove that such is the case. As a result of this presumption, importers will be reluctant to import. They will hestitate to testify concerning trade secrets because they may not want to divulge secret information and cannot be assured that once the information was divulged, their testimony would be believed.

The greatest problem with this proposal is not one apparent on its face but rather is the effect it will have on the generic pharmaceutical industry. This industry is vital in keeping medical costs within the reach of average citizens and reducing the cost of government Medicaid and Medicare.

I. THE TARIFF ACT PROVIDES SUFFICIENT PROTECTION TO PATENT HOLDERS

In seeking relief from the importation into the United States of a product made by a patented process, patentees already have adequate relief under the Tariff Act of 1930, as amended, which provides:

> The importation for use, sale or exchange of a product made, produced or processed, or mined under or by means of a process covered by the claims of any unexpired valid United States letters patent, shall have the same status for the purposes of section 1337 of this title as the importation of any product or article covered by the claims for any unexpired valid United States letters patent.

19 U.S.C §1337a (1940).

§1337a is implemented by §1337 which states:

> (a) Unfair methods of competition and unfair acts in the importation of articles into the United States, or in their sale by the owner, importer, consignee, or agent of either, the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and commerce in the United States, are declared unlawful, and when found by the Commission to exist shall be dealt with, in addition to any other provision of law, as provided in this section.

19 U.S.C. §1337(a) (as amended in 1975).

In a long line of cases, beginning with Frischer v. Bakelite Corp., 39 F.2d 247 (C.C.P.A. 1930), the courts have construed unfair acts and unfair methods of competition to include patent infringement. However, prior to 1940, the courts differentiated between the importation of patented products and the importation of products made by patented processes. Although the courts found the importation of the former to be prohibited by the statute, there was conflict as to whether the importation of the latter was also prohibited. In 1940, Congress amended the Tariff Act, giving the importation of products produced by a patented process the same status as the importation of patented product, 19 U.S.C §1337a. Hence, their importation is now also considered an unfair method of competition.

The International Trade Commission, therefore, will not allow goods to be imported if two conditions are met:

1. the importation of these goods has the effect or tendency to destroy or substantially injure an industry or prevent its establishment and

2. the industry is efficiently and economically operated.

Although these conditions may at first glance seem difficult to demonstrate, the judicial gloss placed on these requirements makes it relatively easy for a patent holder to use the statute to protect private rights.

A. Requirements of §1337a

1. Tendency to Substantially Injure an Industry

For a patent holder to invoke the aid of §1337a, destruction of an industry or even any damaging effect need not be shown. It is only necessary to show a tendency to destroy or substantially injure the industry. This can be shown by the "ratio of infringing imports to domestic production, the volume of imports, import trends, import prices (vis-a-vis domestic prices), foreign capacity, and sales and profit in the domestic industry." In re Certain Combination Locks, 205 U.S.P.Q. 1124, 1127 (U.S.I.T.C. 1979), quoted in Rosenberg, Patent Law Fundamentals 18-29 (Mar. 1983). However, although these factors may be alleged to establish a tendency to injure, it is sufficient to show merely that the unfair methods and acts have resulted in conceivable losses of sales. In re Von Clemm, 229 F. 2d 441 (C.C.P.A. 1955).

Admittedly the statute is not cast in terms of the private rights of a patent holder, instead it refers to the industry. Thus, a key question then becomes how "industry" is defined. In several cases, the courts have viewed the relevant industry as consisting of no more than the complainant's business. In re Von Clemm, 229 F.2d 441 (C.C.P.A. 1955) defined the relevant industry, in a patent infringement case involving the importation of products made by a patented process, in terms of the complainant's business. The patent holder was the sole American producer of star rubies and saphires and although the business was part of the larger domestic synthetic gem industry, the court defined industry in terms of Von Clemm's business.

> There is nothing in the statute which requires that an industry must be of any particular size, or that more than one company must be involved before the protections provided by the statute may be invoked.

Id. at 444.

This reasoning follows earlier decisions such as In re Orion Co., 71 F.2d 458 (C.C.P.A. 1934) where a manufacturer and seller of slide hookless fasteners succeeded in preventing fasteners manufactured in a foreign country by plaintiff's patented process from entering the United States on the grounds that it was hurting its own business.

The treatment of "industry" in terms of a particular business is reflected in the 1975 amendments to the Tariff Act which allow the Trade Commissioner, rather than the President, to exclude products from the United States. 19 U.S.C. §1337(a) (1975). The President's authorization is no longer required because the statute is not limited to broad purposes of shaping and influencing international trade. As noted by a former member of the General Counsel to the Tariff Commission, "Frequently, use of §1337 complaints had been made by domestic industries where smaller firms are operating and/or the level of imports is not of sufficient magnitude to alone have significant impact on U.S. trade." Kaye Revitalization of Unfair Trade Causes in the Importation of Goods: An Analysis of the Amendments to Section 337 (pt. 1), 57, Journal of the Patent Office Society 208, 226, n.52 (1975).

To support the allegation that imported goods will have the effect or tendency to destroy or substantially injure an efficiently and economically operated domestic industry, 19 C.F.R. §210.20 (1982) requires certain information, which should be readily available to the patentee, to be presented in the complaint. The complaint must include a statement of the unfair methods of competition and, various data concerning the sales of domestic articles and imports. It must describe specific instances of alleged unlawful importations or sales, any litigation concerning the unfair methods, the domestic industry affected and complainant's business. Where a product made by a patented process is imported, the complaint must identify each U.S. letters patent, the ownership and assignment of each patent, each domestic licensee, and *if known* must provide a non-technical description of the invention, reference to the relevant patent claims, a showing of domestic production of the article or domestic utilization of the process and a showing that each violator is importing the goods. Although the list is long, none of these requirements can be overly burdensome to patent holders given their ready access to the required information.

2. An "Economically and Efficiently Operated" Industry.

The second requirement of §1337 is that the industry potentially being injured is economically and efficiently run. There is little or no case law on the meaning of economically and efficiently run. It is therefore unlikely that this requirement would act as an obstacle to the patentee in obtaining protection for his process.

B. Advantages of a §1337 Proceeding Over a Patent Infringement Action

In addition to easily and adequately protecting a patentee's rights, a §1337a action has many advantages for a patent holder compared to a patent infringement action in a federal court. An action before the Tariff Commission may be less expensive than an action in federal court where high litigation costs are incurred.

In a §1337 action the patent holder is not limited simply to an exclusion order; if the Commissioner believes that §1337 is being violated an order can be issued to the importer to cease and desist from engaging in the unfair methods of making, using or selling the imported product (§1337(f)). Although a cease and desist order is less radical than an exclusion order, the availability of this remedy can work to the advantage of the patentee as noted by the Senate Finance Committee in its 1974 report:

> Such an order could be modified or revoked at any time, and when revoked, could be replaced by an exclusion order. It is clear ... that the existing statute, which provides no remedy other than the exclusion of articles from entry, is so extreme or inappropriate in some cases that it is often likely to result in the commission not finding a violation of this section, thus reducing the effectiveness of §337 for the purposes intended.

Sen. Rep. No. 93-1298, 93d. Cong., 2d Sess. 4 reprinted in 1974 U.S. Code Cong. and Ad. News 7186, 7331.

The investigation must be completed by the Commission within one year or, if it is considered a "complicated case", within eighteen months. §1337(b)(1).

A patentee may also be more successful in obtaining a temporary exclusion order from the Tariff Commission where a tendency to injure may be shown, whereas a preliminary injunction from a federal court requires irreparable injury and likelihood of success.

The Commission's jurisdiction is nationwide under §1337 and its authority to issue exclusion orders does not depend upon obtaining jurisdiction over any person or any entity. Feller, U.S. Customs and International Trade Guide 19-10 (Feb. 2, 1983).

The patentee, further, need not prove the validity of his patent, as the Commissioner will assume the patent is valid unless the question of validity is raised as a defense. Certain Large Video Matrix Display Systems and Components Thereof, 213 U.S.P.Q. 475, 480 (U.S.I.T.C. 1981), quoted in Rosenberg, Patent Law Fundamentals 18-29 (Mar. 1983).

Given the ease of satisfying §1337 requirements as well as the advantages of a §1337 action relative to a federal court proceeding, the patentee is already amply protected.

C. Maintaining the Balance between Society's Needs and the Patent Holder's Rights.

The Tariff Act of 1930 and its amendments, 19 U.S.C. §1337(a)-(j), seek to balance society's interests which are in competition with the patentee's interests. The 1975 amendments require that the Commission seek the advice of any appropriate agency, such as the Department of Health, Education and Welfare, in excluding the importation of products made by a patented process, and that it consider the effects of these exclusions on the public health and welfare.

This need to balance the patentee's rights against society's interests originates in the Constitution. The Constitution allows inventors to obtain exclusive rights to their inventions only in order to promote the progress of science and the useful arts. Patent rights are predicated on the contribution to society. This intent of the Framers should be heeded when legislation is proposed which may well harm consumers.

II. COUNTRIES WHICH DO BAR IMPORTS OF GOODS MADE THROUGH PATENTED PROCESSES UNIFORMLY HAVE ACTIVE USE REQUIREMENTS AND COMPULSORY LICENSE PROCEDURES IN PLACE.

Proponents of the amendment argue that most of the advanced European countries have barriers against goods made abroad through locally patented processes. They fail to mention that each of these countries insists that the patent owner actually work the patent, usually within three years. Such countries include Belgium, Denmark, France, the Netherlands, Norway, Sweden and the United Kingdom. (Hamelink, Manual for the Handling of Application for Patents, Octrocibureau Los En Stigter (looseleaf binder 1936)).

In fact most of these countries also have compulsory licensing, if the government finds the patent is unused or even that it is underused and greater production would be of benefit to the country. Among these countries are: Australia, Austria, Brazil, Canada, Denmark, France, Germany, India, Ireland, Israel, Japan, Korea, Mexico, the Netherlands, Norway, South Africa, Sweden, Switzerland, Taiwan, United Kingdom. Id.

We found no country where a patent holder can leave a patent idle and yet stop others from either making the product or importing it, and also even from paying for the right to produce it. And yet that would be the result of the proposed amendment.

This would be a radical departure from the patent system as it has functioned either in this country or elsewhere.

Further, every industry has been expected to function and has functioned with foreign competition, since patent protection began. The burden of persuasion is upon those who would have us depart from a balance known to work.

III. EFFORTS TO RESTRICT THE RIGHT TO IMPORT HAVE REPEATEDLY BEEN DEFEATED BECAUSE NO NEED FOR RESTRICTION HAS BEEN DEMONSTRATED AND IT INSTEAD WOULD BE HARMFUL

During 1967 and 1968 over 10 bills were introduced in the Congress aimed at locking out foreign competition. They died in committee thanks to the opposition of the Justice Department, the Commerce Department, the Commissioner of Patents and various consumer groups.

The General Counsel of the Department of Commerce wrote to the Senate Patent Subcommittee on the previous version of this amendment:

> The Department strongly opposes the broad importation provision since there has been no showing of a compelling need for such a provision. Moreover, a broad importation provision would appear to pose an unacceptable burden to importers who would be faced with the costly task of determining by what process the products they imported were made, the facts being unavailable in the United States. Without the limitation of the proviso, the proposed legislation would assume a serious threat to the public interest.

For the General Revision of the Patent Laws, 1968, Hearing on S.2, S.1042, S.1377, S.1691, S.2164, S.2597 before the U.S. Senate Subcommittee on Patents, Trademarks, and Copyright, 90th Cong., 2d Sess. 731 (1968) (Statement of General Counsel, Dept. of Commerce).

Also on the subject of extraterritorial expansion of the patent laws, the Assistant Attorney General in charge of the Antitrust Division, Donald Turner, testified:

> I would say that the two main questions we raised were these: (1) Has any need been shown which would make the proposal something of considerable importance? We were not aware that any extensive need had been shown, and the President's Commission re-

> port simply has the conclusory statement that there was.
>
> (2) A provision of this kind certainly in the blanket form in which it was proposed . . . would impose some very serious practical problems for importers of goods. If I am an importer of a good, a product, and somebody comes to me and says this product infringes a product patent held by him, a U.S. product patent held by him, my job of determining or having it determined for me whether that is true, whereas it may be difficult, is relatively easy. You have the two products. You can get a patent lawyer, and he can look at the prior art. He can attempt to establish how good the patent is and you can compare the two products. There they are. Now, if I am an importer and somebody comes to me and says, "You are infringing not because the product is an infringing product, but it was made by a process which infringes my U.S. process patent," the only way I can determine or my lawyer can determine whether that is so is to make an investigation abroad in the country of origin and try to endeavor to find out whether the product that I have imported was in fact produced by an infringing process. That can be a very costly operation. (Emphasis added).
>
> So, the short of it is that I think any provision of this kind will cause at least some importers, unless they are indemnified by the foreign manufacturer, simply to abandon the importation rather than undergo the expense of trying to determine whether there is infringement or not.

General Revision of the Patent Laws, 1967, Hearings on H.R. 5924, H.R. 13951 before Subcommittee No. 3 of the Committee on the Judiciary, House of Representatives, 90th Cong., 1st Sess., 146 (1967).

The Commissioner of Patents, Edward Brenner, explained his opposition was based on finding "no real need" for further patent expansion. Patent Law Revision, 1967, Hearings on S.2, S.1042, S.1377, S.1691 before the U.S. Senate Subcommittee on Patents, Trademarks and Copyrights, 90th Cong., 1st Sess. 134 (1967) (statement of Edward Brenner, Commissioner of Patents).

IV. THE PATENT EXPANSION COULD HAVE DEVASTATING EFFECTS ON THE GENERIC DRUG INDUSTRY AND ON CONSUMERS

The drawbacks of extraterritorial extension would be particularly severe in fields such as the pharmaceutical industry. Concentrated industries including pharmaceuticals are characterized by "high seller concentration, high barriers to entry, and high product differentiation." Economic papers 1966-1969 by Bureau of Economics FTC; Profitability in the Drug Industry: A Result of Monopoly or a Payment for Risk? p.149. Because of the high product differentiation stimulated by intensive advertising, there is little effective competition and very little incentive to contain prices for the retail or wholesale consumer.

One witness before the Subcommittee on Health and the Environment explained the situation as follows:

> ...there is a great deal of evidence that the U.S. drug industry has become increasingly concentrated into fewer hands since the 1960's. As R. & D. costs escalate, for a variety of reasons and as R. & D. activity increasingly becomes channeled into established research pathways rather than new breakthrough pathways, the large dominant firms have come to account steadily for a higher proportion of total industry discoveries and sales.
>
> As oligopoly tightens, as the opportunity for competition narrows in the development phase of drugs, the commercial rewards for success become more probable than ever before for each oligopolist.

Health and the Environment Miscellaneous--Part 2: Hearings on H.R. 1663 Before The Subcommittee on Health and The Environment, 97th Cong., 1st Sess. 392(1981) (statement of Leonard G. Shifrin). He went on to explain that to the extent there is any room left for competition it will serve as a "competitive offset" to the "increasing monopoly power of those who grow ever more dominant in the R. & D. activity and in the procurement of patents."

The powerful position major pharmaceutical firms often hold is further strengthened by their ability to develop extensive blocking patents, patents which they maintain simply to keep competition out. Only one fifth to one third of U.S. patents are ever used, according to one study. C. T. Taylor and Z.A. Silberston, The Economic Impact of the Patent System (1973). One researcher, Richard Gilbert, has demonstrated that in many industries may be more profitable at times to develop the blocking patent and never use it than to develop the product. Richard Gilbert, Patents, Sleeping Patents, and Entry Deterrence. (n.d.).

Such industries are also often characterized by complicated licensing agreements which might not quite constitute anti-trust violations but yet work as very effective entry barriers. One author explained:

> The Senate Antitrust and Monopoly Subcommittee found that large firms rarely grant patent licenses to their small competitors, although licensing of other large firms is common.
>
> [F]ew of the smaller companies even attempt to secure licenses from the larger manufacturers, either under patent applications or issued patents.

Miller, Patent License Restrictions In The Prescription Drug Industry 53 Va. L. Rev. 1283 (1967). Increased patent protection, then, in an industry which is already characterized by high seller concentration, extensive blocking patents and non-compulsory licensing agreements, would only make it more difficult for consumers to obtain needed drugs at affordable prices.

The tension between the interests of consumers and the major pharmaceutical firms lies in providing incentive for the companies to engage in the optimal amount of research and development while providing consumers with affordable drugs.

Currently, the major name drug firms have exclusive rights to products manufactured and sold in the United States using their patented processes. The question now arises whether they should also have exclusive rights to products manufactured in foreign countries using their patented processes and sold in the United States. The answer depends on the costs and benefits to society of granting these additional rights to the patentees.

A. The Perceived Benefits

Supposedly, the benefits resulting from this proposal would be more research and development. However, according to numerous recent business and financial reports, research and development in the drug industry is already thriving. Investments in research and development account for approximately 54% of the industry's income versus approximately 35% for the companies in the Standard & Poor's 400. Profits will Flow from Research, Business Week, Jan. 17, 1983, p. 77. Relying on Smith Kline estimates that the market could increase to $217 billion which is 300% more than the 1981 market, the article's author concludes that such gains almost guarantee a compounded sales growth of at least 12% a year for the next 8 years. Id. at 80; see also Blue Chip Bet On Research, Barron's Nov. 8, 1982, p.16.

In the past, the major drug firms have maintained that investment in research is on the decline because of increased costs and a reduced return on investment. They argue that extraterritorial patent protection is one way of insuring increased return and thus stimulating increased investment.

In fact, the Office of Technology assessment published a report in 1980 particularly addressing the oligopolistic situation in the drug industry. They found: "[r]evenues of the pharmaceutical industry have increased steadily and the relationship between revenues and R. & D. expenditures has remained stable." Patent Term Extension and the Pharmaceutical Industry, Office of Technology Assessment (1980) p.4.

In hearings on the question of competition and its effect on research and development expenditures, the assistant project director of the Patent Term Extension Project, Office of Technology Assessment, Donna Valtri, testified that increased patent protection accrues to the few firms which have developed financially successful drugs. "The increased revenues may serve to reinforce their dominance in particular areas and hence in the markets those firms serve. Therefore, other firms may be discouraged from entering these areas." Patent Term Extension and Pharmaceutical Innovation, 1982: Hearings before the Subcommittee on Investigation and Oversight, 97th Cong. 2d Sess. (1982) (statement of Donna Valtri, Assistant Project Director, Patent Term Extension Project, Office of Technology Assessment).

Ms. Valtri noted, according to her research, that increased competition was as likely to spur further research and development investments as it was to discourage it. The OTA found no way of determining which possibility was the more likely. Id.

Proponents of the extraterritorial protection imply that increased profits will lead to an increased rate of research and development investment as well as an absolute increase in dollars invested. The problem, however, is that often the majority of their investment takes the form of mere product differentiation or advertising, without technological advance. In other words, the American public provides the drug industry with one dollar of income with the hope that they will spend approximately seven cents of it on research and development. See Health and The Environment Miscellaneous--Part 2 (1981): Hearing on H.R. 1663 before Subcommittee on Health and The Environment, 97th Cong., 1st Sess. 413 (1981) (statement of Fred Wegner, Pharmaceutical Specialist, American Association of Retired Persons and National Retired Teachers Association).

B. The Real Costs

As with most other industries, the result of restricting competition is increased prices. These high prices help make the drug industry extremely profitable. The drug industry's 5-year average return on total capital is 15.5% compared to an all-industry median of 11% (this industrywide median comprises 1,001 public companies listed by Forbes); its 5-year average return on equity is 20.2% compared to an all industry median of 15.9%. Forbes 35th Annual Report on American Industry-Drugs, Forbes, Jan. 3, 1983, p. 192. The drug industry has argued that these high prices represent a risk premium which compensates the industry for money spent in developing products which either do not receive FDA approval or are not market successes. In 1968, the FTC Bureau of Economics in a paper presented before the Monopoly Subcommittee of the Select Committee on Small Business concluded that these large profits are due to high entrance barriers and are not due to risk.

> . . . [I]n the classic tradition, the market power enjoyed by drug firms has been achieved primarily because the leading drug companies have been able to fence themselves off from effective competition and in this sheltered position they have garnered extremely high profits - profits which the economist would label as "abnormal" or "excessive", profits substantially above the competitive norm.

Profitability in the Drug Industry; a Result of Monopoly or a Payment for Risk, (pt. 1), Economic Papers of the Bureau of Economics 1966-1969, p. 144.

The report finds that price competition is ineffective because of (1) patent protection and (2) advertising and promotion. Increased patent protection would only increase the drug companies' "sheltered position", thereby, allowing the companies to charge prices which would lead to profit above those already "abnormally" or "excessively" high. This comports with the observation made by investment analysts noted in the same report that anything threatening to decrease the use of generic drugs, i.e. additional import restrictions, will preserve the branded drug companies' high profits if not increase them.

Given the high prices being charged by the major pharmaceutical companies for their drugs, a real need currently exists for generic drugs. That need has been shown by the current trend towards increased use of lower-priced generic drugs by hospitals and pharmacists as well as by consumers. According to the Federal Trade Commission, the use of generic drugs is increasing because of:

> (1) FDA sanctioning of generics as substitutes;
>
> (2) continued repeal of antisubstitution laws;
>
> (3) promotion of lower-cost drugs by retail pharmacies since dollar margins are often greater than on brand name drugs;
>
> (4) adoption of price control programs for government and third party reimbursements of prescription costs;
>
> (5) expanding promotions of generic equivalents by major industry firms . . .

Federal Trade Commission, Staff Report, Drug Product Selection, 40 (1979). Increasing patent protection for the major drug firms would limit the availability of generic drugs, hence leaving unsatisfied a real demand.

CONCLUSION

Considering all of the above factors, only one position is tenable: given the sure and obvious dangers which this legislation poses as well as its less than clear benefits, this bill should be defeated.

Senator **Mathias**. Again, I will remind you that the record will remain open for 3 weeks for additional statements and material.

The subcommittee stands adjourned at the call of the chair.

[Whereupon, at 11:13 a.m., the subcommittee adjourned at the call of the Chair.]

APPENDIX

ADDITIONAL SUBMISSIONS FOR THE RECORD

STATEMENT BY THE

AD HOC COMMITTEE TO IMPROVE
THE PATENT LAWS

IN RESPONSE TO THE

STATEMENT OF

ALFRED B. ENGELBERG
PATENT COUNSEL
GENERIC PHARMACEUTICAL INDUSTRY ASSOCIATION

BEFORE THE SENATE COMMITTEE ON JUDICIARY
SUBCOMMITTEE ON PATENTS, TRADEMARKS AND COPYRIGHTS

UNITED STATES SENATE

ON S.1535

PRESENTED APRIL 3, 1984

In response to the statement submitted by Mr. Alfred B. Engelberg, Patent Counsel to the Generic Pharmaceutical Industry Association, at the hearing on April 3, 1984 with respect to the process patent amendments of S.1535, the Ad Hoc Committee to Improve the Patents Laws has the following comments.

On page 1 of his statement, Mr. Engelberg refers to the adequacy of the Tariff Act (19 USC 1337) particularly section 1337(a). We believe that is not the case. This section requires that there be "an industry efficiently and economically operated, in the United States" before a remedy is given. The remedy itself is purely exclusionary. No damages are permitted. If goods have already been imported before the ITC acts, there is no remedy at all for the process patent holder. Frequently, imports go undetected for a substantial time before some event occurs which brings importing activities to the patentee's attention, enabling the patentee to seek relief at the ITC. There is no law which requires an importer to declare publicly that he is about to import merchandise which if made in the U.S., would infringe an extant U.S. patent. Furthermore even though a temporary exclusion order is available this can be avoided by the importer posting a bond.

The present law is also useless to a number of those who own patents or who are licensed under patents. For example, an individual, a university or a small business may own a patent but, if the patent has not yet been utilized in this country, the patent owner cannot show that an industry is destroyed or substantially injured. Many such patent owners, for example universities, can only make money by licensing.

The Patent Law wisely contains no condition that an industry must be "efficiently and economically operated". It permits a patentee to continue to innovate and does not penalize the patentee if adequate financing to support such an industry is unavailable. Frequently, utilization of a patented process requires a large economic investment. This investment may be greater in the United States with our concern for worker and environmental safety than it is in other countries. For these reasons, the patentee may not have been able to perfect his process to the point of practical application or may not have been able to raise adequate capital to do so, whereas, some foreign entity, in a nation with different standards, may have learned of the process from the patentee's patent and may be practicing it with significantly less investment than would be required for the patentee to do so in the United States. Furthermore, the patentee in inventing the patented process, may have developed closely related alternative processes which may even be superior to the process of the patent in question. Competition from a country with a lower standard of living and possibly lower worker safety or environmental concerns than the United States, should not be encouraged by permitting that competition to use a process which may not be the best result of the patentee's research but may be close enough to be competitive when used in a country where capital and operating expenditures are less.

In a further statement beginning on page 1, Mr. Engelberg concludes that it would be somewhat anomalous to give foreign patent owners greater protection at this time compared with domestic patent owners. As we understand the point, we do not believe it is correct. Under the proposed legislation, contrary to some foreign patent laws, process protection does not extend to the product of the process. Furthermore the proposed protection would not therefore be greater for foreign patent owners - it would be the same as for domestic patent owners. Interestingly enough, it should be noted that the seventy some organizations supporting this legislation are nearly all U.S. organizations who are certainly not interested in giving foreign patent owners greater protection. However, they do support this particular legislation.

On page 2 Mr. Engelberg states that the U.S. patent laws are not out of step with the rest of the world in refusing to enforce process patents more broadly. We believe that is clearly not the case.

For example, a large number of the important industrial countries have specific provisions in their law relating to enforcing process patents. For example, Section 60(1)(c) of the Patents Act of 1977 of Great Britain provides that a person infringes a patent for an invention "where the invention is a process, he disposes of, offers to dispose of, uses or imports any product obtained directly by means of that process or keeps any such product whether for disposal or otherwise." In West Germany the Patent Law provides in Article 6 "If the patent has been granted for a process, the effect shall also extend to the products obtained directly by means of such process." Many other major countries have similar provisions.

Mr. Engelberg also raises a point regarding "working". First of all, we find that a rather irrelevant issue. The fact that some countries have user requirements and compulsory licensing does not seem very relevant to the issue of enforcement of process patents. Foreign relief for off-shore infringement is not tied to considerations of working or compulsory licensing.

Assuming S.1535 is passed, there are three options available to a process patentee. He (1) will be working the patent and seek injunctive relief and money damages against an infringer; or (2) will not be working the patent asserted but will be working an alternate related patented process and still should be entitled to overall protection for his business; or (3) will not be working the patent asserted nor be in the relevant business, in which case he will be after royalty income not injunctive relief (which would make no sense); in fact this is what would happen if the United States did have compulsory licenses for nonworking. Therefore, Mr. Engelberg's argument about compulsory licensing for nonworking makes no practical sense. In any case, the patent owner would not be trying to deprive the public of the benefit of his new process. In retrospect, we wonder if Mr. Engelberg is trying to help foreign manufacturers.

Turning to specifics, Mr. Engelberg implies that the United Kingdom has a compulsory licensing provision for drug patents. This is not so. The U.K. did have such a provision but revoked it a few years ago after Parliament found it to have undesirable consequences.

And, furthermore, as to working, the situation is not as simple as what Mr. Engelberg states it to be. For example, there is the further possibility that working requirements might be satisfied through a bilateral agreement. Illustratively, the exchange of notes between the Swiss and United States governments that entered into force January 28, 1908 accept working of a patent in the territory of one of the parties as equivalent to its working in the territory of the other party. The same provision applies between the United States and West Germany pursuant to the treaty of August 1, 1909. A different approach is that taken by Japan whereby importation of the patented product ranks as working. Yet, while these countries have waived the local working requirements for nationals of other countries they have not at the same time denied inventors protection for the direct product of a process invention.

In line 5 of page 3, Mr. Engelberg refers to a patent owner reaping "monopoly profits". In this regard, we note footnote 3 of the recent decision of the Court of Appeals for the Federal Circuit in Carl Schenck v. Nortron Corporation, 218 USPQ 698 (1983) in which Chief Judge Markey states that "It is but an obfuscation to refer to a patent as 'the patent monopoly'..." Chief Judge Markey also states that "nowhere in any statute is a patent described as a monopoly. The patent right is but the right to exclude others, the very definition of 'property'."

Further on page 3, Mr. Engelberg states there is no real evidence to support the assertion that proceedings before the ITC are cumbersome. While it is true that the mandatory time limit provides a decision sooner than might be available in a federal court there is no merit to the contention that the proceeding in the International Trade Commission is less expensive. The scope of the inquiry in the International Trade Commission is the same as would be in a federal court with respect to validity infringement and associated defenses. The scope of discovery is the same. The evidentiary and procedural rules applied at the hearing in the International Trade Commission are substantially the same. In effect, the proceeding under Section 337 includes all that is included by a federal court action under a United States patent. Thus, the costs involved in pursuing a Section 337 proceeding with respect to patent issues are the same as would be involved in a federal court proceeding except they are compressed within a shorter time period.

More significantly, however, the additional issues presented under Section 337 - the effect or tendency to destroy or injure an industry efficiently and economically operated in the United States and the public health and welfare and competitive conditions in the United States economy - substantially increase the costs involved in a Section 337 proceeding. The assembly of detailed economic information, the involved discovery made necessary by the economic issues, the necessity to provide for economic experts to testify at the hearing regarding the state of the domestic industry, the potential injury to the domestic industry and the public health and welfare and competitive conditions in the United States all substantially increase the cost of an ITC proceeding over that of a Federal court proceeding. None of the economic issues present in a Section 337 proceeding are relevant to a proceeding in a district court action for patent infringement.

While as mentioned above the ITC may grant a temporary exclusion order precluding the import of infringing articles during the period of the investigation, practically this remedy is not available. The investigation necessary to decide on a temporary exclusion order is virtually coextensive with the overall investigation and occupies a substantial portion of the time limit provided for the total investigation. In fact, the ITC has issued only one temporary exclusion order since amendment of the Tariff Act of 1930 in 1975.

The difference between a district court action and the Section 337 proceeding is also apparent from the point of view of the alleged infringers. The determination of the ITC under Section 337 is not res judicata, thus presenting the alleged infringer with the prospect of relitigating the same issues in a Federal court. Indeed, because of the different jurisdictional bases, ITC proceedings under Section 337 are frequently concurrent with Federal court proceedings. Frequently respondents initiate Federal court action seeking a declaratory judgment of patent invalidity because the ITC is not empowered to declare a patent invalid. Thus, in terms of conservation of judicial resources and the swift resolution of disputes, the Federal court proceeding has significant advantages over the Section 337 proceeding.

At the bottom of page 3, Mr. Engelberg says that in a typical buy/sell situation, the buyer may neither know nor care about the process used by a supplier. While this is true as is the fact that often the buyer may not know nor care about all the details of the product he is selling, it is not readily apparent what that has to do with patent infringement.

On page 4, Mr. Engelberg discusses the burden of proving infringement or non-infringement, stating that it makes no sense to put the burden of proof of non-infringement of a patent on the importer of products. We believe that it is much easier for the importer to discover the process from his manufacturer than it is for the patent owner, who has no connection whatsoever with the manufacturer, to find out what the process is.

Furthermore, without this proposal, the process patent protection under consideration could become a nullity. Indeed, in many countries where process patents can be asserted against importers, there is a so-called reversal of the burden of proof. This reversal operates to require the importer to prove that the imported goods were made by a process which does not infringe the patent. Given the unavailability of pre-trial discovery in countries outside the United States, such a reversal is absolutely essential in our domestic legislation. Consider the problems of obtaining discovery in an Iron Curtain country or the PRC. Even obtaining discovery in countries with a judicial system with which we feel more comfortable, such as Switzerland, can be very cumbersome and onerous.

Also, it should be noted that a number of foreign countries provide the logical step of making the person who has readier access to the process bear the burden of proof. For example, in West Germany, Article 47(3) states "in the case of an invention whose subject matter is a process for the production of a new substance, any substance of the same nature shall, in the absence of proof to the contrary, be deemed to have been produced by the patented process".

Another argument presented in opposition to the proposed legislation is the adverse impact it would have on importation. The reasoning is that a foreign manufacturer would be reluctant to enter into a district court action in the United States in defense of its customer because of the prospect of having to disclose trade secret processes to establish the non-infringement of a U.S. process patent. The protective orders routinely granted by district courts are given short shrift as lacking reliability and substance.

First of all, it has been proposed to include in the legislation that the burden of proving infringement remains upon the patent owner unless "a substantial likelihood exists that the product was produced by the patented process". The effect of such a provision is to require the court to determine a preliminary issue before shifting the burden to the alleged infringer. While no standard is mandated in the proposed legislation as to the level of proof necessary, comparable language with respect to preliminary injunction, i.e., substantial likelihood of success, indicates that the evidence necessary to establish the "substantial likelihood" will be more than a mere allegation. It would appear, for example, that the presentation of an alternative process not covered by the patent claims, whether or not the actual process used by the alleged infringer would, be sufficient to avoid the shifting of the burden of proof.

The assertion that foreign manufacturers would be loath to disclose their trade secret processes in Federal court and therefore would stop importing products into the United States is without foundation. It is contended that the protective orders issued by the Federal courts are insufficient to protect the trade secrets of the foreign manufacturer. It would appear, therefore, that these foreign manufacturers would not participate in an International Trade Commission proceeding as they would similarly be obligated to disclose the processes they use under the protection of a protective order. Thus, the International Trade Commission is not any better a forum that the Federal courts with respect to this issue and the reluctance of manufacturers to protect their importers or customers in the United States will not turn on the trade secret issue, but rather on the size of the market that the manufacturers perceive. Whether it be in the ITC or the Federal courts, the manufacturer will participate in the proceeding if it is in his economic interest.

Apparently, Mr. Engelberg feels that it is better to have process patent infringement, which is usually done by someone copying the invention rather than developing his own process, than to require the alleged patent infringer to show that he is not infringing the patent.

Furthermore as to the value of protective orders in Federal courts the Ad Hoc Committee, based upon their experience, has a contrary view to that of Mr. Engelberg. Scrupulous care *is* taken to ensure that judicial protective orders are observed. Certainly our courts expect no less. Indeed in the recent, as yet unpublished decision, of the CAFC (*U.S. Steel Corporation, et al* v. the *United States and U.S. International Trade Commission et al*, decided *March 23, 1984*) the court takes exactly this view (i.e. that judicial orders are observed) in ruling that material given to outside counsel should not be precluded from access by house counsel solely by virtue of their role as house counsel.

The opening of the second paragraph on page 5 of Mr. Engelberg's statement referring to proof of foreign acts in an interference context or as an anticipation seems to be a non-sequitur. However, in this paragraph Mr. Engelberg does refer to the "evidentiary barriers [which] exist with respect to proving infringement [outside the U.S.]". It is exactly for this reason, that a provision reversing the burden of proof is an absolute necessity.

Specifically, Mr. Engelberg states that "...under 35 USC section 104, a foreign applicant may not rely on any activities in a foreign country for the purpose of establishing priority of invention." (emphasis added) Mr. Engelberg has apparently overlooked the language in Section 104 which refers to Sections 119 and 365 wherein it is clear that a foreign applicant can get the benefit of a filing date in a foreign country under normal circumstances. Section 365 also refers to obtaining the benefit of rights of priority of patent applications filed in foreign countries.

On the top of page 6 of his statement, Mr. Engelberg complains that the foreign infringer may have been the first inventor or have been engaged in the actual use of the patented subject matter for many years prior to the issuance of the U.S. patent and yet could be found guilty of infringement (in contrast with the lack of concern for foreign manufacturers exhibited in the text at the top of page 2). In practice this could only be so if the foreign manufacturer kept his process secret or used it secretly or even though not kept secret the process was not described in a printed publication.

We see no harm or injustice in that situation. One of the purposes of the patent law is to encourage disclosure of inventions in return for the right to exclude others from using the invention for a limited period of time. Indeed secrecy is the antithesis of the patent law since in that case there is is no contribution to the public good.

In the last paragraph on page 6, Mr. Engelberg states that our present law (Tariff Act) already provides for enforcement of process patents against imported products, etc. Stating that the present law is adequate does not make it so. As pointed out in the statements filed by the supporters of S.1535 and the foregoing comments, the present law does not provide adequate protection for owners of process patents when the products are imported from other countries.

In conclusion we observe that there is broad support for the process patent amendments - from industry, from universities and from the Administration. The need for the process patent amendment has been recognized for many, many years. Unfortunately it has not become the law because it was included with other amendments which were controversial. We believe the time is ripe to correct this deficiency in our patent laws.

Comments of Louis Kaplow, Assistant Professor, Harvard Law School, on S. 1841, Title III

My name is Louis Kaplow. I am on the faculty of Harvard Law School, where I teach Antitrust Law, among other courses. I am currently completing a comprehensive reexamination of the interface between patent and antitrust policy, entitled *The Patent-Antitrust Intersection: A Reappraisal*, which will appear in the June 1984 issue of the *Harvard Law Review*. Based upon my research, along with my understanding of how the legal system processes complex antitrust disputes, I conclude that the primary provision of S. 1841 that addresses antitrust policy -- Title III -- are misguided and potentially quite dangerous.

Sec. 27. (a) - Elimination of Per Se Illegality

The proposed Section 27(a) provides that "Agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws." The fundamental problem with this provision is that its effects might well extend vastly beyond the apparent thrust suggested both by the language of this subsection and by the arguments now offered in support of this change.

1. *The provision is tantamount to per se legality of anticompetitive conduct in the exploitation of intellectual property.* On its face, this provision purports to eliminate the rule of per se illegality of various restrictive practices when employed in the process of exploiting rights related to intellectual property. Robbed of the per se rule, courts would necessarily apply the rule of reason in its place. The rule of reason has inherent appeal in that it always appears sensible to advocate a careful consideration of all relevant factors. Yet the effect of this change will no doubt be quite different. Judge, then-Professor, Richard Posner -- who is certainly not an advocate for retaining most of antitrust's per se rules -- was forthright in observing that "The content of the Rule of Reason is largely unknown; in practice, it is *little more than a euphemism for nonliability*." [45 U. Chi.

L. Rev. 1, at 14 (1977).] Although Judge Posner may have overstated the point somewhat, there is certainly substantial truth in what he says. First, the massive litigation often necessary to prosecute a case under the rule of reason can be stifling not merely for small businesses or other private plaintiffs, but for the government as well in light of the ever-present scarcity of enforcement resources. Second, the complex inquiry invited by the rule of reason creates built-in biases in favor of antitrust defendants because courts are understandably reluctant to become enmeshed in the intricate economic analysis that is typically necessary to sort out all the unique circumstances of a given case. As significant as this problem is in other antitrust cases, it will inevitably be worse in cases involving the exploitation of intellectual property since the range of complexity is greater.

A related issue is that it is most uncertain what sort of analysis the proponents of this legislation envision that courts will make under the new, open-ended regime. In the antitrust context, courts are motivated to create per se rules in the first place because the experience of seeing a wide range of cases convinces them (a) that the practice is virtually always undesirable and (b) that it is far too difficult to determine in any given case whether an exception is warranted. Since the proponents for the most part do not seriously challenge the second of these conclusions, it is unclear how they can expect the results to be any different under their rule of reason unless, as suggested in the preceding discussion, courts react to the complexity by ruling in favor of defendants despite concerns that serious dangers may exist.

2. The provision is vastly overbroad and threatens to repeal covertly a large portion of antitrust law. Section 27(a) might have the effect of withdrawing antitrust protections from a broad sector of the economy. The primary source of this danger is that virtually any anticompetitive practice might be made part of an agreement as described in 27(a) and thus benefit from relaxed -- or eviscerated -- regulation. The risk is especially great in the light of numerous past examples where defendants have incorporated anticompetitive restraints into agreements relating to the exploitation of

intellectual property, when the benefit of the attempted subterfuge was much less than it would be under Section 27(a).

For example, a price restricted license or pooling agreement can operate as a legal, enforceable cartel. Even if the patent or other intellectual property involved in the scheme was virtually worthless in terms of its economic contribution, nothing prevents a licensing or pooling arrangement from fixing prices vastly above what would be justified by the value of the invention. In response, it might be said that courts could detect such schemes even under a rule of reason analysis. But a number of factors suggest that there would still be substantial room for danger. Since no per se rule could be applied under Section 27(a), regardless of the nature of the arrangement, the court would be forced to make an independent determination concerning factors such as the true economic value of each patent, how high prices would have been in the absence of the arrangement, and whether any of a wide range of explanations proffered by creative litigators and expert witnesses might justify the arrangement. To give some idea of how costly and complex this would be, consider just the first item - the true economic value of the patent. Antitrust courts have shown particular reluctance to become involved in resolving economic issues surrounding the innovation process, to the point that many have essentially dismissed antitrust claims because the prospect of in-depth investigation was so foreboding. Second, the entire process by which we reward invention through patent and copyright protection rather than by providing direct prizes[1] is justified in large part on the ground that it would be to difficult to determine, even approximately, the value of any given invention.

The conclusion, therefore, is that the legislation threatens to wipe out a substantial part of antitrust protection in situations where it is possible for the offending firms to establish some link between the anticompetitive practice and their exploitation of some right relating to intellectual property. Yet the problem is even worse than this formulation suggests, because intellectual property rights are in some way connected with a huge portion of commerce in the United States. A large fraction of products, including probably all sold by our major industries, in some way incorporate intellectual property rights. As a result, the rollback of the antitrust laws that results from Section 27(a) may be nearly complete, rather than confined to the incremental portion of value that arises from newly developed intellectual property.[2]

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[1] In theory, the direct prize approach would be preferable since it avoids all the monopoly costs associated even with exploitation that is confined within antitrust proscriptions.

It thus is essential that Section 27(a) be interpreted narrowly, so that such an expansive effect is avoided. It might be thought that this could be accomplished by courts limiting the immunity granted in 27(a) to exploitation strictly confined to the scope of the protected property right. But this formulation is in fact quite similar to the approach courts *currently* use in determining whether, for example, restrive practices of patentees are in violation of the antitrust laws. In addition, there is the problem that the "scope" of intellectual property rights is not readily defined. Current rules in antitrust law as it applies to intellectual property are the result of an almost century-long attempt to provide content to such a scope limitation. Section 27(a) seems designed to tell the courts to be much more lenient, but does not tell them when to be more lenient and more importantly, where to stop before antitrust protections become eviscerated.

Sec. 27. (b) - Elimination of Treble Damages

The proposed Section 27(b) essentially eliminates the trebling of damages in private antitrust actions. To the extent 27(a) is vastly overbroad, as argued above, so is the repeal of treble damage remedies. In fact, the problem here is worse because even if the new rule of reason approach leads to the conclusion that the violation was most flagrant, there would still be no treble damages.

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[2] Another cause of potential overexpansion latent in Section 27(a) is its inclusion of trade secrets, know-how, and "other intellectual property." These terms, unlike the provisions for patents, copyrights, and trademarks, are quite open-ended. The are often not clearly delineated in statutory law, vary state by state, and can be interpreted so expansively as to include virtually every business practice in existence, now or in the future. Thus, even those anticompetitive practices that could not be linked with some agreement in connection with a patent, copyright, or trademark would still have a great chance of claiming immunity under 27(a). (It is also the case that trademarks themselves cover a very broad range of products.)

In addition to these dangers, the limitation of treble damages is misconceived in that it invites violation of the antitrust laws. One function served by treble damage provisions is general deterrence. The problem is that the vast majority of antitrust violations are never detected or, if detected, cannot be prosecuted. Thus, a firm contemplating conduct in direct violation of the antitrust laws faces a biased calculus: even though violation may not be profitable if the firm is punished, there is still a substantial incentive for violation because the probability of punishment is so low. Treble damages compensate for this built-in bias. Years of economic analysis has provided rigorous support for the intuition that it is generally desirable that the penalty be increased when there is a significant chance that not all violators will be punished.

Eliminating treble damages would not merely undermine deterrence by decreasing the penalty on those offenders who are punished. It would also decrease the likelihood that offenders would be prosecuted in the first instance, because if damages are sufficiently low, it will no longer be profitable to bring suits. Of course, the high costs of antitrust litigation are well known, so the problem is quite serious. Moreover, provision 27(a), by making every such case into an open-ended rule of reason inquiry, actually increases the costs of bringing such suits. Thus, the double-barrelled effect is that suits are much more expensive to bring and offer far less reward when successful, leading to a substantial diminution in the incentive to sue. And this is in addition to the direct undermining of the deterrence effect described previously.

Conclusion

My extensive research in the area of patent-antitrust law has led me to the position that there are substantial unresolved issues that must be faced if antitrust policy in this area is to be improved. The proposed Section 27 does not address these complex issues, but rather embarks upon a dangerous path of blindly rolling back antitrust protections. Even the general direction of this change has received little analytical support. Yet even if one were confident that antitrust law should be even further limited than is already the case in its application to the exploitation of intellectual property rights, Section 27 is not well designed to implement such an objective. Instead, the proposed legislation raises serious dangers of:

1. Making anticompetitive conduct per se legal,
2. Covertly repealing a large portion of antitrust law in instances not intended to be reached, and
3. Inviting violation of the antitrust laws.

Such results are consistent with a general hostility to all protections of the antitrust laws but is inconsistent with a desire to provide optimal incentives for the development of intellectual property in a manner that is consistent with maintaining an economy reasonably safe from serious anticompetitive behavior.

CORRESPONDENCE

Stauffer Chemical Company
Westport, Connecticut 06881 / Tel. (203) 222-3000 / Cable "Staufchem"

April 6, 1984

Ralph Oman, Esq.
Chief Counsel
Patents, Copyrights and Trademarks
SD-137 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Subject: Opposition to S. 1535

Dear Mr. Oman:

As Director of the Patent Department at Stauffer Chemical Company, I am sending this letter on behalf of my company with the request that it be placed in the record of the hearing for S. 1535 for review by the subcommittee.

S. 1535 is retroactive legislation and, consequently, can result in far-reaching unforeseeable effects well beyond what it purports to accomplish. For this reason, it is potentially unfair. To the extent that it is retroactive in nature, we believe it fails to benefit the public and it will also fail to stimulate innovation, at least to the extent that it applies to past inventions beyond hope of stimulation.

If this bill were amended to make it only prospective in nature, we could support it. As our objections are not to the concepts expressed, but only to its retroactive application.

Since we have a direct interest in those sections of the bill establishing a new standard under Section 184, 185 and 186 of title 35 USC, I would address this section of the bill specifically, although it is believed that every section of this bill should be made prospective. It is believed that this can be easily accomplished by amending Section 11 of this bill in a manner as set forth below.

My company is party to patent litigation, filed more than a year ago. The history of the patent involved appears to have many facts in common with the Gaertner case 202 USPQ 714 (1979). We have claimed a defense under 35 USC 184 and 185. If S. 1535 becomes law in its present form, this defense might well be eliminated. This will possibly benefit our opponent. It could damage us. It cannot be said to benefit the public or stimulate innovation. It is not known how many other such cases exist or where else it will affect the rights of U.S. companies.

This legislation will change the standards or tests by which the sanctions of 35 USC 184 et seq. can be avoided. The standards should be changed prospectively. The results of retroactive legislation are unpredictable and, worse, will be unintended.

The results can be inequitable as they are designed to help those who cannot meet the present standards to the detriment of others who are acting in reliance on the present tests. Ex post facto deprivation of rights could result from those relying on the current law.

Section 11 of this proposed bill is directed to patents past and future and, consequently, in both instances can be retroactive.

It is respectfully requested that Section 11 of the subject proposed bill be deleted in its entirety and be replaced by the following:

> "The amendments made by this act shall apply to any United States patent application having a filing date or claiming the benefit of a filing date subsequent to the enactment of this act and to patents issuing on such applications."

By limiting Section 11 to patent applications with a filing date subsequent to the date of this act, it will make the act prospective. By including patent applications claiming the benefit of a filing date after the date of the act, it will prevent continuation applications or continuation-in-part applications from being used to obtain the benefit of the act for old cases through fortuitous pending applications. In summary, it will make this act equitable and prospective in nature. It will no longer be retroactive and we would then support it.

I would further note that there is an additional question in respect to this area. By changing the standards, it might well encourage repeated carelessness in respect to foreign patent practice vis-a-vis 35 USC 184 et seq. Congress should be well aware of the full ramifications of this change.

While the other sections of this act do not have an immediate impact on our company, I feel the same limitations should apply to the other provisions and they should be prospective in nature. Retroactive effect can be inequitable to those who have acted within the law and have adopted a position in reliance upon it. It could result in increased litigation and constitutional questions could certainly be raised. Consequently, I urge the subcommittee to amend Section 11 of S. 1535 as indicated above.

This submission represents a personal and corporate view of the subject legislation. It is not intended in any way to criticize the substantial efforts of those who have proposed or supported this legislation.

Most respectfully submitted,

Robert C. Sullivan

Robert C. Sullivan
Director
Patent Department

RCS/rj
cc: G. Mossinghoff
M. Kirk
T. Mooney
M. Remington

ALLIED

Allied Corporation
P. O. Box 3000R
Morristown, New Jersey 07960
(201) 455-4513

L. J. Colby, Jr.
Senior Vice President
Technology

April 16, 1984

Honorable Charles McC. Mathias
Chairman, Senate Subcommittee on
Patents, Copyrights & Trademarks
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Please include these comments as part of the record of the April 3rd hearing on Bill S.1535:

I wish to express the support of Allied Corporation for S.1535, and most particularly its first section which concerns the infringement of United States patents on processes.

United States industry needs a patent system which fosters technological innovation and provides adequate incentive to develop such innovation. The present patent statute provides a disincentive to innovation in industrial processes. The bill under consideration, S.1535, would remedy this situation.

Under the existing patent statute, a United States corporation, which has invested significant capital in the research and development of an innovative process and has secured a United States patent protecting that process, can find its investment in innovation and its patent protection effectively lost to a competitor who merely practices the very same process abroad and imports its competitive product into the United States before the U.S. corporation has commercialized its product.

The provisions of the Tariff Act (19 U.S.C. §1337 and 1337a) are completely inadequate to remedy the situation. Since Sections 1337 and 1337a require, inter alia, that the importation have the effect or tendency to destroy or substantially injure an industry, efficiently and economically operated, in the United States or to prevent the establishment of such an industry, the foreign competitor can, through the deft timing of its U.S. market entry, preempt the domestic market and preclude any proof of the existence of a domestic industry (or, alternatively, of the prevention of its establishment) and of efficient and economic operation of that industry. The foreign competitor will have reaped the fruits of the U.S. market without having sown any capital on innovation.

In 1983, Allied Corporation initiated an investigation before the United States International Trade Commission based on the infringement of three of its basic United States patents on amorphous metal alloys* by Vacuumschmelze GmbH (a business unit of Siemens AG) of West Germany and Nippon Steel Corporation, Hitachi Ltd. and TDK Electronics Co., Ltd., all of Japan. (Allied's investment in the research and development of amorphous metals technology is in excess of 50 million dollars to date.) One of the three patents is on a process which these companies are practicing in Japan and West Germany. At the present time, their infringement of this patent can be redressed only under Section 1337a. Fortunately, Allied commenced commercial sales in 1979 and has been able to adduce evidence as to both domestic industry and, alternatively, the prevention of its establishment in the International Trade Commission proceeding. However, if Allied's commercialization had not been as well advanced, that evidence would not have been available and Allied would have been without remedy. Consequently, we strongly urge enactment.

Sincerely,

L. James Colby, Jr.

L. James Colby, Jr.

cc: Roy H. Massengill
General Patent Counsel

R. Ray Randlett
Director, Regulatory &
Legislative Affairs

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*These are unique metal alloys which lack the usual crystalline structure of metals. One potential use of these materials is as a high efficiency core material for electric power transformers which, if adopted for widespread use in the U.S. for electric power distribution, would result in a reduction in electric power losses in the U.S. equivalent to about 40 million barrels of oil per year.